

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 14-05**

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This ruling is based on the particular facts and circumstances presented, and is an interpretation of the law at a specific point in time. The law may have changed since this ruling was issued, possibly rendering it obsolete. The presentation of this ruling in a redacted form is provided solely for informational purposes, and is not intended as a statement of Departmental policy. Taxpayers should consult with a tax professional before relying on any aspect of this ruling.

SUBJECT

The application of the Tennessee sales and use tax to a cloud collaboration service.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[TAXPAYER] (the "Taxpayer") provides comprehensive and integrated technology solutions to business, government, education, and healthcare customers through hardware, software, and value-added services.

One such service is a cloud-based collaboration service ("Cloud Collaboration Service"). Organizations receive access to telephone lines through a telephone provider, but often require hardware and software to internally instruct their telecommunication equipment as to how to process

and route calls. Historically, organizations have handled these functions internally, but the Taxpayer's Cloud Collaboration Service serves as an alternative to its customers that provides cloud-based applications and related services to supplement and support a customer's telecommunication equipment. This support augments a customer's voice, video, messaging, presence, audio/web conferencing, and mobile capabilities. The Cloud Collaboration Service therefore eliminates the need for a customer to maintain software and hardware necessary to process and route calls.

The Cloud Collaboration Service includes the following types of services:

Voice

A Taxpayer server, utilizing [BRAND NAME] clusters (the "Cluster"), communicates with the customer's voice gateway device to provide instructions for processing and routing calls among the customer's phone extensions. The call is not routed through the Taxpayer's server. This system also supports a customer's other forms of communication to its Internet Protocol end-points, media-processing devices, Voice Over Internet Protocol gateways, mobile devices, and multimedia applications.

Video

Video is the technology of electronically capturing, recording, processing, storing, transmitting, and reconstructing a sequence of still images representing scenes in motion. Video utilizes components such as [BRAND NAME] IP end-points, or purpose-built video endpoints such as [BRAND NAME SYSTEM] or larger units. The Taxpayer's server provides the video support services through the Cluster in the same manner as outlined above with respect to a customer's voice communication capabilities.

Messaging

When a customer phone extension does not answer an incoming call, the Taxpayer's server, utilizing the Cluster, instructs the customer's voice gateway device to send the call to voicemail. The voice messages are then stored on the Taxpayer's servers and available for the user to access and manage at his or her convenience. The voice messaging support services provided by the Cloud Collaboration Service allow users to access and manage voice messages stored on Taxpayer-owned servers in a variety of ways, using an e-mail inbox, web browser, [BRAND NAME IP PHONE], Smartphone, and [BRAND NAME APPLICATION], among other components.

Presence

The Taxpayer provides presence support services through a [BRAND NAME PRESENCE] application that provides users the ability to determine when colleagues are available and allow instant messaging. The customer's own communications equipment accesses the Presence application hosted on the Taxpayer's servers to utilize the presence capabilities.

Audio Conferencing

With respect to a customer's audio conferencing capabilities, the Taxpayer supports a customer-owned [BRAND NAME] router and phone devices through its hosted Cluster, in a manner similar to that described above with respect to the voice support services.

Web Conferencing

[BRAND NAME CONFERENCING] application is an optional, subscription-based component of the Cloud Collaboration Service that permits desktop sharing through a web browser with phone conferencing and video. [BRAND NAME CONFERENCING APPLICATION] operates through a user's computer or wireless device, an audio connection, and an optional webcam.

Mobility Services

The Taxpayer supports a customer's mobile devices through use of the [BRAND NAME] application. Mobile clients utilizing [BRAND NAME APPLICATION] can place and receive calls over their own corporate wireless local area network and telephony infrastructure, using the Taxpayer's server to instruct the routing of calls. [BRAND NAME APPLICATION] essentially turns a mobile phone into another extension on the Cluster. The Taxpayer's server itself does not provide the routing for the call or otherwise function as a switch.

In order to provide its Cloud Collaboration Service, the Taxpayer owns, leases, or licenses the necessary hardware and software to facilitate its service. The hardware and software required for providing the Cloud Collaboration Service are installed on servers located in [STATE], and the software is not downloaded by the customer. The Taxpayer's employees in [STATE] maintain the hardware and software, and the Taxpayer's employees in [STATE] remotely monitor performance, perform necessary adds, moves, changes, and deletions and provide troubleshooting for issues that arise during performance.

The customer is responsible for obtaining its own telephone, Internet, and network connections, and the Taxpayer relies on the customer's QoS-enabled, voice-grade Local Area Network and Wide Area Network to provide services throughout a customer's geographic location. The Taxpayer does not provide telephone, Internet, or network access.

To purchase the Cloud Collaboration Service, customers enter into a contract with the Taxpayer that includes a customer service order, a service description for the Cloud Collaboration Service, and a detailed pricing invoice.

Under the contract, the Taxpayer charges a customer a monthly user fee¹ calculated based on the number of users of the Cloud Collaboration Service. The monthly fee covers charges for hardware, software, virtual server instances, required storage, rack space, power and cooling, monitoring and management, most moves-adds, and major version upgrades. To the extent a customer purchases add-on services (including the hosting of customer-owned software applications), the Taxpayer

¹ The fee is denominated as a "license" fee, but the Taxpayer does not in fact license or lease any software or tangible personal property (to the customer under the contract).

charges separate fees for each such service. The Taxpayer separately states charges for maintenance and management of any customer-owned software applications on the monthly invoice.

RULINGS

1. Is the Taxpayer's sale of its Cloud Collaboration Service subject to the Tennessee sales and use tax?

Ruling: Yes. The Taxpayer's Cloud Collaboration Service is subject to the Tennessee sales and use tax as the sale of intrastate telecommunications and ancillary services.

2. If the Taxpayer's Cloud Collaboration Service is subject to the Tennessee sales and use tax, is the sale to a Tennessee customer sourced to Tennessee?

Ruling: If the Taxpayer sells its Cloud Collaboration Service to a Tennessee customer, that sale is sourced to Tennessee if the customer primarily uses the service at a street address located in Tennessee.

3. Do the Taxpayer's purchases, leases, or licenses of hardware and software qualify as sales for resale?

Ruling: No. The Taxpayer is considered the user and consumer of the hardware and software that it purchases in providing its service, and, thus, it does not resell such hardware and software to its customers.

ANALYSIS

1. TAXATION OF CLOUD COLLABORATION SERVICE

The Taxpayer's Cloud Collaboration Service is subject to the Tennessee sales and use tax as the sale of intrastate telecommunications and ancillary services taxable under TENN. CODE ANN. § 67-6-205(c)(3), (9) (2013).

Under the Retailers' Sales Tax Act,² the retail sale in Tennessee of tangible personal property and specifically enumerated items and services is subject to the sales tax, unless an exemption applies. "Retail sale" is defined as "any *sale*, lease, or rental for any purpose other than for resale, sublease, or subrent."³

Various transactions may qualify as a sale. One type of "sale" involves "any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatsoever of tangible personal property for a consideration."⁴

² Tennessee Retailers' Sales Tax Act, ch. 3, §§ 1-18, 1947 Tenn. Pub. Acts 22, 22-54 (codified as amended at TENN. CODE ANN. §§ 67-6-101 to -907 (2013)).

³ TENN. CODE ANN. § 67-6-102(76) (2013) (emphasis added).

⁴ TENN. CODE ANN. § 67-6-102(78)(A).

Tangible personal property” includes “property that can be seen, weighed, measured, felt, or touched, or that is in any other manner perceptible to the senses.”⁵ Tangible personal property also includes “prewritten computer software,” which is defined in TENN. CODE ANN. § 67-6-102(68) in pertinent part as “computer software, including prewritten upgrades, that is not designed and developed by the author or other creator to the specifications of a specific purchaser.”⁶ Conversely, the sale or use of intangible intellectual property generally is not subject to Tennessee sales and use tax unless stored on tangible storage media.⁷

In addition to the transfer of tangible personal property, the term “sale” also includes “the furnishing of any of the things or services” taxable under the Retailers’ Sales Tax Act.⁸ One of the “things” specifically taxable is:

[t]he retail sale, lease, licensing or use of computer software *in this state*, including prewritten and custom computer software . . . regardless of whether the software is delivered electronically, delivered by use of tangible storage media, loaded or programmed into a computer, created on the premises of the consumer or otherwise provided.⁹

“Computer software” is “a set of coded instructions designed to cause a computer . . . to perform a task.”¹⁰ Computer software is “delivered electronically” if delivered “by means other than tangible storage media.”¹¹

The sales tax also applies to sales of services specifically enumerated in the Retailers’ Sales Tax Act. The furnishing of “intrastate, interstate or international telecommunication services” is one such specifically enumerated service.¹² “Telecommunications service” is defined by TENN. CODE ANN. § 67-6-102(90)(A) as the “electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points,” and includes

⁵ TENN. CODE ANN. § 67-6-102(89)(A).

⁶ TENN. CODE ANN. § 67-6-102(68) further provides that “[p]rewritten computer software’ or a prewritten portion of the computer software that is modified or enhanced to any degree, where the modification or enhancement is designed and developed to the specifications of a specific purchaser, remains prewritten computer software.” Note, however, that “where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for the modification or enhancement, the modification or enhancement shall not constitute prewritten computer software.” TENN. CODE ANN. § 67-6-102(68).

⁷ Compare *Crescent Amusement Co. v. Carson*, 213 S.W.2d 27, 29 (Tenn. 1948) (rental films are taxable tangible personal property), with *Commerce Union Bank v. Tidwell*, 538 S.W.2d 405, 407 (Tenn. 1976) (finding a tangible method of data transfer “merely incidental” to the underlying transaction, and thus not subject to sales and use tax).

⁸ TENN. CODE ANN. § 67-6-102(78)(C).

⁹ TENN. CODE ANN. § 67-6-231(a) (2013) (emphasis added).

¹⁰ TENN. CODE ANN. § 67-6-102(18).

¹¹ TENN. CODE ANN. § 67-6-102(24).

¹² TENN. CODE ANN. § 67-6-205(c)(3).

“such transmission, conveyance or routing in which computer processing applications are used to act on the form, code, or protocol, without regard to whether such service is referred to as voice over Internet protocol services or is classified by the federal communications commission as enhanced or value added.”¹³

Another sale of a service subject to the sales and use tax is “[t]he furnishing, for a consideration, of ancillary services.”¹⁴ Ancillary services are “services that are associated with, or incidental to, the provision of telecommunication services.”¹⁵ One particular form of ancillary service is a “conference bridging service,” which “links two (2) or more participants of an audio or video conference call.”¹⁶ Conference bridging services, however, do not include “the telecommunications services used to reach the conference bridge.”¹⁷ Another ancillary service is a “voice mail service,” which “enables a customer to store, send or receive recorded messages.”¹⁸

The Taxpayer’s Cloud Collaboration Service therefore is subject to the sales tax if it involves: 1) the sale of tangible personal property; 2) the sale of telecommunications services; or 3) the sale of ancillary services.

No retail sale or use of tangible personal property or computer software occurs in Tennessee when the Taxpayer provides its Cloud Collaboration Service. The Taxpayer’s Cloud Collaboration Service enhances the functionality of a customer’s phone and other telecommunications equipment. The Taxpayer, as a provider of services, ultimately uses and consumes both hardware and software as a means of providing its services. The Taxpayer maintains this hardware and software at its data center outside of Tennessee. Importantly, the Taxpayer does not sell, lease, license, or otherwise provide the use of any tangible personal property or computer software in Tennessee to its customers in conjunction with Cloud Collaboration Service. The Taxpayer does not transfer title, possession, or control of any tangible personal property or software to a customer. Any hardware that the Taxpayer uses remains in [STATE – NOT TENNESSEE]. Moreover, the software applications remain on the Taxpayer’s servers at all times and are never delivered to, transferred to, or installed on a customer’s computers. Thus, no sale of tangible personal property or computer software occurs in Tennessee for sales and use tax purposes.

The Taxpayer’s Cloud Collaboration Service, however, does constitute the furnishing of taxable services in Tennessee for purposes of the Tennessee sales and use tax.¹⁹ All aspects of the Cloud

¹³ TENN. CODE ANN. § 67-6-102(90)(A).

¹⁴ TENN. CODE ANN. § 67-6-205(c)(9). The Taxpayer’s services cannot be characterized as any other type of service that is taxable under the Retailers’ Sales Tax Act. This letter ruling, therefore, does not discuss any specifically enumerated services other than telecommunications services and ancillary services.

¹⁵ TENN. CODE ANN. § 67-6-102(7).

¹⁶ TENN. CODE ANN. § 67-6-102(7)(A).

¹⁷ *Id.*

¹⁸ TENN. CODE ANN. § 67-6-102(7)(E).

¹⁹ The Taxpayer’s Cloud Collaboration Service differs from other cloud computing services accessed by Tennessee customers that are located on servers out of state and excluded from the definition of a telecommunications service

Collaboration Service are taxable telecommunications services, except for the Taxpayer's provision of messaging and audio/web conferencing, which constitute taxable ancillary services.

As stated above, the definition of telecommunications service includes

such transmission, conveyance, or routing in which computer processing applications are used to act on the form, code or protocol of the content for the purposes of transmission, conveyance or routing, without regard to whether such service is referred to as voice over Internet protocol services or is classified by the federal communications commission as enhanced or value added.²⁰

In this case, the Taxpayer's Cloud Collaboration Service uses computer processing applications to provide customers with voice, video, presence, and mobility capability in conjunction with its customers' Public Switched Telephone Network connections. Accordingly, the Taxpayer routes "voice, data, audio, video, or any other information or signals to a point, or between or among points" and uses "computer processing applications that act on the form, code, or protocol of the content for purposes of transmission, conveyance, or routing."²¹ Such services are properly considered telecommunications services and are subject to sales tax.

The Cloud Collaboration Service also involves functions that are considered ancillary services. As discussed above, ancillary services are "services that are associated with, or incidental to, the provision of telecommunication services."²² The Taxpayer's audio and web conferencing services "link two (2) or more participants of an audio or video conference call" and are properly considered "conference bridging services" that come under the umbrella of "ancillary services."²³ The messaging aspect of the Cloud Collaboration Service "enables the customer to store, send, or receive recorded messages," and is thus a taxable ancillary "voice mail service."²⁴

Having concluded that all of the Cloud Collaboration Service is comprised of taxable components, it follows that the entire monthly fee charged by the Taxpayer is subject to sales tax. The applicable rate, however, depends upon whether the Taxpayer's telecommunications services are international, interstate, or intrastate.

as "data processing and information services" through TENN. CODE ANN. § 67-6-102(90)(B)(i). While the primary purpose of other such cloud computing services is to access data and information located on servers, this is not the purpose of the Taxpayer's Cloud Collaboration Service.

²⁰ See TENN. CODE ANN. § 67-6-102(7), (90)(A).

²¹ *Id.*

²² TENN. CODE ANN. § 67-6-102(7).

²³ TENN. CODE ANN. § 67-6-102(7)(A).

²⁴ See TENN. CODE ANN. § 67-6-102(7)(E). Note that for both the Taxpayer's telecommunications services and its ancillary services, it is immaterial that the Taxpayer does not provide the telephone, Internet, or other network services upon which the Taxpayer's services are transferred.

The local tax on international and interstate telecommunications services is limited to only 1.5%, unless the services are provided to a business, in which case they are exempt from the local tax.²⁵ But if the telecommunications services are intrastate in nature, the local tax is imposed at the rate of 2.5%, with no exemption for business customers.²⁶

The Taxpayer's telecommunications services here are intrastate in nature. TENN. CODE ANN. § 67-6-102(47) defines "intrastate" in pertinent part as "a telecommunications service that originates in one (1) United States state . . . and terminates in the same United States state." Although the Taxpayer's data center, software, and hardware are located in the state of [STATE], the Taxpayer's service of using computer processing application information to act on a customer's content occurs where its customer is located. A customer both initiates and terminates the telecommunications service using its own Public Switched Telephone Network Circuits, phone lines, and Internet connections to communicate with the Taxpayer's Cluster. Moreover, customers connect with third parties through Public Switched Telephone Network Connections that are never physically routed through the Taxpayer's data center.²⁷ As such, if a customer is located in Tennessee, the Taxpayer's service both originates and terminates in Tennessee.

Consequently, the Taxpayer's telecommunications services are subject to the 7% state rate and the 2.5% local rate pursuant to TENN. CODE ANN. § 67-6-702(g)(2). Similarly, ancillary services are always subject to the 2.5% local rate pursuant to TENN. CODE ANN. § 67-6-702(g)(2), along with the regular 7% state rate. Finally, because both of the Taxpayer's services are taxed at the same rate, the special bundling provisions of TENN. CODE ANN. § 67-6-539 (2013) are rendered moot.²⁸ The end result is that the entire monthly fee that Taxpayer charges for its Cloud Collaboration Service is subject to sales tax at the 7% state tax rate and the 2.5% local tax rate.

2. SOURCING OF CLOUD COLLABORATION SERVICE WHERE SALE IS MADE TO A TENNESSEE CUSTOMER

The Taxpayer's Cloud Collaboration Service provided to a Tennessee customer is sourced to Tennessee if the customer primarily uses the service at a street address located in Tennessee.

TENN. CODE ANN. § 67-6-905 (2013) sets forth the sourcing rules for sales of telecommunications services in Tennessee. Except for certain situations not applicable here,²⁹ all telecommunications

²⁵ TENN. CODE ANN. § 67-6-702(g)(1) (2013).

²⁶ TENN. CODE ANN. § 67-6-702(g)(2).

²⁷ In other words, while a customer may use their telephone service to call a location outside of Tennessee, which would be interstate in nature, the Taxpayer's Cloud Collaboration Service that augments the customer's telephone service is delivered entirely where the customer is located.

²⁸ See generally TENN. CODE ANN. § 67-6-539 (providing a methodology for determining the appropriate sales tax rates when telecommunications services are bundled with ancillary services subject to a different tax rate); see also TENN. DEP'T OF REVENUE, IMPORTANT NOTICE 05-19 (Oct. 2005), available at <http://tn.gov/revenue/notices/sales/sales05-19.pdf> (last visited July 1, 2014). The Cloud Collaboration Service would constitute a bundle under TENN. CODE ANN. § 67-6-539, but the applicable rates are the same for the telecommunications service component and the ancillary service component, so the statute has no practical effect.

²⁹ See TENN. CODE ANN. § 67-6-905(b) (telecommunication services sold on a call-by-call basis); TENN. CODE ANN. § 67-6-905(d) (other exceptions).

services and ancillary services are sourced according to a customer's "place of primary use," regardless of where the telecommunication originates or terminates.³⁰ "Place of primary use" is "the street address representative of where the customer's use of the telecommunications service primarily occurs, which must be the residential street address or the primary business street address of the customer."³¹

Accordingly, if a customer primarily uses the Taxpayer's Cloud Collaboration Service at a street address located in Tennessee, the sale of the Cloud Collaboration Service would be subject to the sales and use tax in Tennessee. But if a customer primarily uses the Taxpayer's Cloud Collaboration Service at a street address located outside of Tennessee, the sale of the Cloud Collaboration Service would not be subject to Tennessee sales and use tax.

3. THE TAXPAYER'S PURCHASES, LEASES, OR LICENSES OF HARDWARE AND SOFTWARE

The Taxpayer's purchases, leases, or licenses of hardware and software do not qualify as sales for resale in Tennessee.

The Retailers' Sales Tax Act subjects the retail sale of tangible personal property and specifically enumerated services to the sales and use tax. The term "retail sale" means "any sale, lease, or rental for any purpose *other than for resale*, sublease, or subrent."³² Thus, sales for resale are not subject to the Tennessee sales and use tax.

TENN. CODE ANN. § 67-6-102(75) defines a "sale for resale" as "the sale of the property, services, or taxable item intended for subsequent resale by the purchaser" and requires any sales for resale to be "in strict compliance with rules and regulations promulgated by the commissioner." Moreover, TENN. COMP. R. & REGS. 1320-5-1-.32(3) (1987) provides that "tangible personal property sold to be used exclusively for renting or leasing may be sold upon a resale certificate."

Here, the Taxpayer is the end user of the hardware and software that it purchases, leases, or licenses. The Taxpayer, as a provider of services, ultimately uses and consumes such hardware and software as a means of providing its Cloud Collaboration Service. As stated in the response to Question #1, the Taxpayer does not transfer title or possession of the hardware or software to a customer as part of the sale of its services. The software remains on the Taxpayer's servers, and any equipment that the Taxpayer uses to provide the service remains at the Taxpayer's data center. Moreover, a customer cannot manipulate the hardware or software in any way. A customer does not have any access to or use or control of the software, and thus does not have the requisite dominion or control over the software and equipment to constitute possession.³³

³⁰ TENN. CODE ANN. § 67-6-905(c).

³¹ TENN. CODE ANN. § 67-6-905(a)(9).

³² TENN. CODE ANN. § 67-6-102(76) (emphasis added).

³³ "Possession" is not defined under the Retailers' Sales Act. When a term is not defined under that statute, the Tennessee Supreme Court has stated that the term must be given its ordinary and common meaning. *See e.g., Byrant v. Genco Stamping & Mfg. Co.*, 33 S.W.3d 761, 765 (Tenn. 2000); *Tenn. Farmers Assur. Co. v. Chumley*, 197 S.W.3d 767, 782-83 (Tenn. Ct. App. 2006); *Beare Co. v. Tenn. Dep't of Revenue*, 858 S.W.2d 906, 908 (Tenn. 1993). Possession is generally understood to mean "having or holding property in one's power," the exercise of

Accordingly, the Taxpayer's purchases, leases, and licenses of hardware and software do not qualify as sales for resale in Tennessee.

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APPROVED: Richard H. Roberts
Commissioner of Revenue

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dominion over property, or the right to exercise exclusive control over something. *See* BLACK'S LAW DICTIONARY 1281 (9th ed. 2009); *see also Ford v. Okla. Tax Comm'n*, 285 P.2d 436, 437-48 (Okla. 1955). In this case, the Taxpayer's customers have none of these incidents of possession.