

Sales of Computer Software Maintenance Contracts

Computer Software Maintenance Contract Is Defined by State Law

Tennessee law specifically defines a computer software maintenance contract. It is a contract that obligates one person to provide to another person future updates, upgrades and/or support services for computer software.

Computer Software Maintenance Contracts Are Subject to Sales and Use Tax

The sale of, use of, or subscription to a computer software maintenance contract in Tennessee is subject to sales and use tax. It does not matter whether the purchase is a mandatory requirement to obtaining the computer software, or the purchase is optional and separately priced and invoiced from the computer software covered by the software maintenance contract. Sales or use tax is due under each of the following circumstances:

1) A Computer Software Maintenance Contract Is Taxable if Sold in Conjunction with a Taxable Sale of Computer Software

A computer software maintenance contract is taxable if it is sold as part of a Tennessee taxable sale of computer software.

Example: A purchaser buys computer software in Tennessee from Tennessee Computer Software Dealer ("TCSD"). At the same time, the purchaser also buys a software maintenance contract that covers repairs of the software he is purchasing. TCSD charges Tennessee sales tax on the sale of the

software. The sale of the contract is also subject to the Tennessee sales tax.

2) A Computer Software Maintenance Contract Is Taxable if the Software Is Installed on a Computer in Tennessee

A computer software maintenance contract is taxable if the computer software covered by the computer software maintenance contract is installed on a computer in Tennessee.

Example: A purchaser buys a computer software maintenance contract from Software Maintenance Contract Dealer ("SMCD"). The contract covers repairs to software that is installed on the purchaser's Tennessee office computer. The sale of the contract is subject to the Tennessee sales tax, and SMCD would collect and remit the tax. However, if the sales tax was not collected on the purchase, the purchaser would owe Tennessee use tax on the purchase price of the contract.

3) A Computer Software Maintenance Contract Is Taxable if the Location of the Software Is Unknown, but the Purchaser Has a Tennessee Address

A computer software maintenance contract is taxable if the location of the computer software covered by the computer software maintenance contract is unknown, but the purchaser's residential or primary business address is located in Tennessee.

Example: Tennessee Purchaser ("TP") buys a computer software maintenance contract from

Tennessee Software Maintenance Contract Dealer ("TSMCD"). The maintenance contract covers repairs of software that TP bought from another dealer. TSMCD does not know where the software is installed, but it does know that TP's primary business address is in Tennessee. The sale of the contract is subject to Tennessee sales tax.

Computer Software Maintenance Contracts Are Subject to Both Sales and Use Tax

Software maintenance contracts are subject to the Tennessee use tax. Therefore, if a purchaser buys a software maintenance contract in another state, and the seller does not collect tax on that purchase, the purchaser will owe use tax on the purchase price of the contract covering the computer software installed on computers in Tennessee. Furthermore, if a seller collects another state's sales tax, and the rate of the tax was lower than the Tennessee sales and use tax rate, then the purchaser will owe use tax on the difference between the out-of-state tax paid and the amount that would be owed based on the Tennessee tax rate. However, if the rate of the other state's tax is equal to or greater than the Tennessee sales and use tax rate, then the purchaser will not owe any additional use tax in Tennessee.

Separate Sales of Support Services Are Not Subject to Sales and Use Tax as Part of the Computer Software Maintenance Contract

Sales of support services that meet all three of the following conditions would not be taxable as part of the software maintenance contract:

- 1) the seller sells the support services separately from the sale of the computer software maintenance contract,
- 2) the purchaser is not required to purchase the support services in order to purchase the software maintenance contract, and
- 3) the support services do not include the installation, transfer, repair or maintenance, including updates and upgrades, of the computer software.

Example: A dealer sells computer software, computer software maintenance contracts and support service agreements. The software maintenance contract includes updates and fixes to the software, technical support and installation services. The support service agreement covers help desk and customer service support, basic usability of the software and Q&A assistance with software functionality. Sales of the support service agreements are not subject to tax when they are sold separately from the software and software maintenance contracts.

The Single Article Tax Limitation Does Not Apply to Computer Software Maintenance Contracts

The total sales price for a computer software maintenance contract is subject to the state tax rate plus the applicable local tax rate. The local option single article tax limitation on the first \$1,600 of the sales price of tangible personal property does not apply to the sale or use of a computer software maintenance contract.

Computer Software Maintenance Contracts Covering Software Installed on Computers Located Both Inside and Outside Tennessee Are Taxable Only on the Tennessee Portion

When a computer software maintenance contract applies to computer software that is installed on computers located both inside and outside the state, then Tennessee sales or use tax is only due on the percentage of the sales price that correlates to the percentage of the software installed in Tennessee.

Example: A purchaser buys a computer software maintenance contract from Software Maintenance Contract Dealer ("SMCD"). The contract covers repairs to software that is installed on the purchaser's Tennessee office computer and three of the purchaser's Florida office computers. The purchaser pays a monthly subscription fee of \$1,000 for the contract. Only \$250, or 25 percent, of the monthly subscription fee would be subject to the Tennessee sales or use tax. The monthly subscription fee of \$1,000 should be included in Line 1 Gross Sales and \$750 should be included in

Schedule A, currently Line G (Sales in Interstate Commerce), of SMCD's sales and use tax return.

No Additional Tax Is Due on Repairs Performed under a Computer Software Maintenance Contract

If sales or use tax is paid on the computer software maintenance contract, then no additional tax will be owed on any of the repairs or maintenance (including updates and upgrades) to the software that are performed as part of the contract. However, if any repairs or maintenance to the software are not covered by the contract, then those repairs will be subject to the sales tax.

Example 1: A purchaser purchases a maintenance contract from Computer Seller ("CS") that covers the purchaser's software. The purchaser's software has a glitch, and it must be repaired. The repair is covered by the maintenance contract, and so CS repairs the software at no charge. No sales tax is owed on the repair.

Example 2: A purchaser purchases a maintenance contract from Computer Seller ("CS") that covers the purchaser's software. The purchaser's software must be repaired. However, because of the nature of the repair, it is not covered by the maintenance contract, so CS charges \$100 for the repair. Sales tax will be owed on the \$100 charge.

For More Information

Visit www.tn.gov/revenue. Click on Revenue Help to search for answers or to submit an information request to one of our agents.

References

Tenn. Code Ann. § 67-6-102; Public Chapter 273 (2015)