

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 00-32**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Application of sales and use tax to the sale of computer software to customers in Tennessee.

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] is engaged in the business of selling [SOFTWARE] products for use throughout large and medium size organizations. These products are considered “canned software.” The taxpayer collects the appropriate Tennessee sales tax on the software delivered on physical media into Tennessee. All shipments originate from outside the state, but the taxpayer has nexus with Tennessee.

The taxpayer is implementing a new delivery system whereby the customers will be able to download the taxpayer’s software from the taxpayer’s web site directly into the customer’s computer systems. Customers will only be given access to the web site after executing a contract to license the software.

The taxpayer also purchases software products from third-party vendors and resells them to customers. Such third-party products are shipped directly from the third-party to the taxpayer’s customer on physical media. These products are invoiced separately from the taxpayer’s software products. The taxpayer collects Tennessee sales tax on the sale of third-party software.

Finally, the taxpayer also ships unsolicited advertisements for third-party products to its customers in Tennessee. These advertisements are in the form of printed material or trial-offer software on physical media. They are shipped via common carrier, and there is no charge for such items.

QUESTIONS

1. Is the sale and delivery of canned computer software delivered entirely via electronic means subject to sales and use tax?
2. Does the answer to Question #1 change if the taxpayer sells third-party software products, as described in the facts, to the same customer who purchases the taxpayer’s software?
3. Does the answer to Question #1 change if the taxpayer ships advertisements for third-party products to customers in Tennessee, as described in the facts?
4. Are the advertisements for third-party products, as described in the facts, subject to use tax?

RULINGS

1. Yes.

2. No.
3. No.
4. Yes.

ANALYSIS

1. – 3. The sale of customized or packaged computer software, as well as the modification of existing software, is subject to sales and use tax. T.C.A. §67-6-102(24)(B);¹ *University Computing Company v. Olsen*, 677 S.W.2d 445 (Tenn. 1984); *Creasy Systems Consultants, Inc. v. Olsen*, 716 S.W.2d 35 (Tenn. 1986). When selling software that is delivered on physical media to customers in Tennessee, the taxpayer properly collects the tax. The taxpayer requests a ruling on whether sales and use tax would still apply if the software was delivered, instead, via electronic means through the taxpayer's Internet web site.

In *Creasy Systems Consultants*, the Tennessee Supreme Court addressed the question of whether the transfer of a tape, disc, cards, or other tangible media on which computer programs are contained is necessary in order to have a taxable sale of computer software. *Creasy Systems Consultants, Inc.*, 716 S.W.2d at 36. The court held that “the legislature intended to tax the transfer or fabrication of computer programs whatever the means used, excepting only the fabrication of computer software by a person for his own use.” *Id.* (emphasis added).

Accordingly, the sale of computer software in Tennessee is subject to sales and use tax whether delivered on physical media or by electronic means.

Under the facts presented, the shipment of advertisements for third-party software and the sale of third-party software delivered on media have no bearing on whether the sale of the taxpayer's software is subject to tax.

4. The taxpayer also requests a ruling on whether the advertisements shipped to customers in Tennessee are subject to use tax. These advertisements are in the form of printed material or trial-offer software. They are unsolicited, provided at no charge, and shipped to the taxpayer's Tennessee customers via common carrier.

T.C.A. § 67-6-203 provides in pertinent part as follows:

¹ The term “sale” is defined to include “[the] transfer of customized or packaged computer software, which is defined to mean, information and directions loaded into a computer which dictate different functions to be performed by the computer whether contained on tapes, discs, cards, or other device or material. For such purpose, computer software shall be considered tangible personal property; however, the fabrication of software by a person for such person's own use or consumption shall not be considered a taxable ‘use’....” T.C.A. §67-6-102(24)(B).

(a) A tax is levied at the rate of six percent (6%) of the cost price of each item or article of tangible personal property when the same is not sold but is used, consumed, distributed, or stored for use or consumption in this state; provided, that there shall be no duplication of the tax.

(b) A tax, which shall be paid by the distributor, is also levied at the rate set out in subsection (a) on the value of catalogues, advertising fliers, or other advertising publications distributed to residents of Tennessee; provided, that this tax shall not be duplicative of a sales or use tax otherwise collected on such publications. "Distributor" does not include the commercial printer or mailer of any such catalogues, advertising fliers, or other advertising publications; nor shall nexus to a taxpayer be established through a relationship with a commercial printer or mailer having a presence in Tennessee; nor shall the commercial printer or mailer have the obligation of collecting any such tax.

T.C.A. § 67-6-203(a) and (b).²

Advertisements distributed by the taxpayer to residents of Tennessee in the form of printed material fall within the provisions of T.C.A. § 67-6-203(b) and are subject to use tax. To prevent duplication of the tax, credit is allowed for sales or use tax legally imposed and actually paid to another state on such material. T.C.A. § 67-6-507(a); Tenn. Comp. R. & Regs. 1320-5-1-.91.

Trial-offer software distributed by the taxpayer is similarly subject to use tax under T.C.A. § 67-6-203(a). Such software is tangible personal property that is not sold but is distributed and used in this state. *See J.C. Penney Company, Inc. v. Olsen*, 796 S.W.2d 943 (Tenn. 1990). Again, to prevent duplication of the tax, credit is allowed for sales or use tax legally imposed and actually paid to another state on such material. T.C.A. § 67-6-507(a); Tenn. Comp. R. & Regs. 1320-5-1-.91.

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² In addition to the six percent (6%) state tax, a local option tax is imposed under T.C.A. § 67-6-701 et seq., on the same privileges and in the same manner as the state tax.

APPROVED: Ruth E. Johnson
Commissioner

DATE: 9/29/00