

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #08-16**

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 the Tennessee sales and use tax to billing services performed out-of-state.

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] owns and operates a proprietary customer billing system. The Taxpayer is based outside of Tennessee and does not have any locations in Tennessee. The Taxpayer grants users access to the billing system in exchange for an initial one-time fee and a monthly fee based on system usage. Prior to accessing the system, users must install the Taxpayer's software, which is transmitted to users either by remote telecommunications from the Taxpayer's place of business

or accessed from the Taxpayer's servers. The software serves as an interface allowing users and the Taxpayer to communicate on an ongoing basis. The Taxpayer receives a one-time fee for provision of the software interface.

At the most basic level, the Taxpayer's billing system provides wireless telecommunication carriers ("carriers") a means of producing invoices for their wireless subscribers. The carriers/users provide the Taxpayer with static data inputs (subscriber name, address, credit, rate plan, etc.); the Taxpayer pulls and accepts dynamic data from the carriers' systems; the Taxpayer processes the data creating new data which is sent to an out-of-state third-party printer in electronic form; and the third-party printer prints and mails the new data in the form of billing invoices to the carriers' subscribers. The Taxpayer receives the following monthly fees: a) a fee based on the type and volume of data processed; b) a reimbursement relating to expenditures made on behalf of its carriers for procurement of printing and mailing services; and c) an administrative fee for acting as the intermediary between the carrier and the third-party printer. These items are separately stated on the Taxpayer's monthly invoices to its carriers.

QUESTIONS

1. Must the Taxpayer charge Tennessee sales and use tax on a one-time licensing fee related to the licensing of computer software?
2. Must the Taxpayer charge Tennessee sales and use tax on a monthly fee related to the provision of billing services?
3. Must the Taxpayer charge Tennessee sales and use tax on reimbursements and administrative fees related to the procurement of printing and mailing services?

RULINGS

1. Yes. The one-time licensing fee related to the licensing of computer software is subject to Tennessee sales and use tax.
2. No. The provision of billing services by the Taxpayer is not subject to Tennessee sales and use tax.
3. No. The reimbursements and administrative fees related to the procurement of printing and mailing services are not subject to Tennessee sales and use tax.

ANALYSIS

Retail sales in Tennessee are subject to sales and use tax under Tenn. Code Ann. § 67-6-101 *et seq.* Tenn. Code Ann. § 67-6-102(68) (2007) defines a "retail sale" to include any "sale, lease or rental for any purpose other than for resale, sublease or subrent." A "sale" is defined as "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," and includes "the furnishing of any of the things or services taxable" under the Tennessee sales

and use tax laws. Tenn. Code Ann. § 67-6-102(70)(A)&(D) (2007). The sale of prewritten computer software is considered a sale of tangible personal property under Tenn. Code Ann. § 67-6-102(80)(A) (2007). The sale of telecommunications services is subject to sales tax pursuant to Tenn. Code Ann. § 67-6-205(c)(3) (2007).

1. *Licensing Fee.*

The one-time licensing fee related to the licensing of computer software is subject to the Tennessee sales and use tax.

The software program licensed by the Taxpayer meets the definition of “prewritten computer software” for purposes of the Tennessee sales and use tax. “Prewritten computer software” is computer software that “is not designed and developed by the author . . . to the specifications of a specific purchaser.” Tenn. Code Ann. § 67-6-102(60) (2007). Prewritten computer software includes “software designed and developed by the author . . . to the specifications of a specific purchaser when it is sold to a person other than the purchaser.” *Id.* Under the facts presented, the Taxpayer’s software is not designed and developed to the specifications of a specific purchaser, and therefore comes within the definition of “prewritten computer software.”

The software program licensed by the Taxpayer qualifies as tangible personal property for the purposes of the Tennessee sales and use tax. Tenn. Code Ann. § 67-6-102(80)(A) specifically includes “prewritten computer software” in the definition of tangible personal property. Additionally, the Taxpayer’s software license agreement constitutes a lease of tangible personal property. The lease or rental of tangible personal property, including prewritten computer software, is included in the definition of “sale” under Tenn. Code Ann. § 67-6-102(70)(A) and is subject to sales and use tax. Therefore, the payments made to the Taxpayer pursuant to the license agreement for leasing the software are subject to the Tennessee sales and use tax.

2. *Billing Services.*

The provision of billing services by the Taxpayer is not subject to Tennessee sales and use tax.

Tenn. Code Ann. § 67-6-205(c) (2007) lists the services that are specifically taxable in the State of Tennessee. However, specifically taxable services are not subject to taxation if performed out-of-state. *See LeTourneau Sales and Service, Inc. v. Olsen*, 691 S.W.2d 531 (Tenn. 1985) (holding that services are taxable where they are performed). Charges for any services necessary to complete a sale of tangible personal property or taxable services are also subject to sales tax. Tenn. Code Ann. § 67-6-102(71)(A)(iii) (2007). Therefore, a service is subject to Tennessee sales and use tax if it is: 1) a specifically taxable service rendered in Tennessee, or 2) a service necessary to complete a sale of tangible personal property or taxable services.

According to the facts provided, the Taxpayer provides billing services to carriers. The Taxpayer’s billing service is subject to the Tennessee sales and use tax only if it is specifically listed in the Tennessee Code as a taxable service, and is performed in Tennessee. Under Tenn. Code Ann. § 67-6-205(c), the following services are subject to tax in Tennessee:

- (1) The sale, rental, or charges for any rooms, lodgings or accommodations furnished to transients by any hotel, inn, tourist court, tourist camp
- (2) Charges for services rendered by persons operating or conducting a garage, parking lot, or other place of business for the purpose of parking or storing motor vehicles . . .
- (3) The furnishing, for a consideration, of either intrastate or interstate telecommunication services . . .
- (4) The performing for a consideration of any repair services . . .
- (5) The laundering or dry cleaning of any kind of tangible personal property . . .
- (6) The installing of tangible personal property which remains tangible personal property after installation . . .
- (7) The enriching of uranium materials . . .
- (8) The renting or providing of space to a dealer or vendor without a permanent location in this state . . .
- (9) The furnishing, for a consideration, of ancillary services.

With the possible exception of telecommunication services, discussed below, the Taxpayer does not provide these or any other services in Tennessee.

The Taxpayer pulls dynamic data from its customers; therefore, intrastate or interstate telecommunications services do in fact take place in order for the Taxpayer to provide its service. The term “telecommunication service” is defined under Tenn. Code Ann. § 67-6-102(81)(A) (2007) 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.” The term includes transmission, conveyance, or routing “in which computer processing applications are used to act on the form, code or protocol of the content for 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.” *Id.*

However, under the facts provided, there is no sale of telecommunications from the Taxpayer to its customers, because the true object of the Taxpayer’s service is not to provide telecommunications services. The true object of the Taxpayer is to provide the billing service; similarly, it is the billing service, and not telecommunications services, that the customer seeks to purchase. In the present case, the product created and sold by the Taxpayer was information, not telecommunications services. Telecommunication was merely the method of transmitting this information to the Taxpayer’s customers. Stated another way, the true object of the transactions was not telecommunications services, but was rather the information itself. See *Equifax Check Services, Inc. vs. Johnson*, 2000 WL 827963 (Tenn.Ct.App. 2000) (holding that check guarantee service, and not telecommunications services, was true object of transaction). Telecommunications services are only a means incidental to the provision of the Taxpayer’s service. This is clearly different from a situation in which the telecommunication is one of the primary objectives of the transaction. Accordingly, under these facts, there is no sale of telecommunications from the Taxpayer to its customers.

Since the Taxpayer does not sell telecommunications services and does not provide another taxable service in Tennessee, its monthly fees are not subject to Tennessee sales and use tax.

3. *Reimbursements and Administrative Fees.*

The reimbursements and administrative fees related to the procurement of printing and mailing services are not subject to Tennessee sales and use tax.

The Taxpayer pays a third-party printer to print and mail the billing invoices to the carriers' subscribers. The third-party is located outside of Tennessee. The Taxpayer purchases the printing and mailing services as part of its agreement to provide billing services to its customers. The Taxpayer is reimbursed by its customers and receives administrative fees for contracting with the third-party printer.

These reimbursements and administrative fees could be taxable if they accompanied the sale of tangible personal property in the State of Tennessee. Charges for any services necessary to complete a sale of tangible personal property or taxable services are also subject to sales tax. Tenn. Code Ann. § 67-6-102(71)(A)(iii).

However, under the facts provided, the billing service provided by the Taxpayer is not incidental to the sale of tangible personal property or taxable services. As such, the reimbursement and administrative fees are not subject to sales and use tax in Tennessee. *See* Tenn. Code Ann. § 67-6-102(71)(A)(iii). The Taxpayer's primary purpose in contracting with the third-party to print the statements is to provide billing services for its customers. The customers do not purchase statements so much as billing services, which include the printing and mailing of billing statements. The use of tangible personal property such as billing statements and envelopes is an essential component of this service, and does not change its nature as a service. The billing service remains non-taxable despite the use of tangible personal property in providing those services.

Note that the Taxpayer may incur use tax liability for printed materials distributed in Tennessee. Tennessee imposes the use tax on tangible personal property imported from other states and used by a dealer in Tennessee. Tenn. Code Ann. § 67-6-210(a) (2007). The Tennessee Supreme Court has held that "[w]hen the primary function and purpose of the Taxpayer is to provide services, the ownership, use and maintenance of certain types of personal property and equipment are necessary in order to enable it to furnish the services so that the Taxpayer, not its customer, is the ultimate user or consumer within the meaning of sales and use tax statutes." *Nashville Mobilphone Co., Inc. v. Woods*, 655 S.W.2d 934, 935-37 (Tenn. 1983). Consequently, the Taxpayer is the user or consumer of the billing statements and envelopes necessary to provide the billing service. To the extent the Taxpayer imports or causes such items to be imported into Tennessee, the Taxpayer must pay Tennessee use tax on the items pursuant to Tenn. Code Ann. § 67-6-210(a). However, the Taxpayer will receive credit against its Tennessee use tax liability for any properly imposed sales tax paid to another state. TENN. COMP. R. & REG. 1320-5-1-.91.

In summary, the Taxpayer is reimbursed by its customers and receives administrative fees for contracting with the third-party printer. However, since the billing service provided by the Taxpayer is not incidental to the sale of tangible personal property, the reimbursement and administrative fees are not subject to Tennessee sales and use tax.

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APPROVED: Reagan Farr
Commissioner

DATE: 2/29/08