

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 13-15**

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 various transactions involving online gaming and other digital content.

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”) makes retail sales to Tennessee customers on its website and at its stores located in Tennessee.

The [REDACTED] products sold by the Taxpayer include the following:

Access Codes for Remotely Accessed Software/Virtual Goods

Retail consumers purchase digital content for use in an online video game that resides on a third party server.¹ Additionally, the customers purchase virtual goods online, either by paying to access an online game or by paying to access additional content within an online game. At its retail stores, the Taxpayer sells access codes [REDACTED], which allow customers to access the described content on a third party server. The Taxpayer also plans to sell access codes via its website; in such cases, the customer will print out or otherwise record the code for later use. Examples of items in this category are completely web-based games such as [EXAMPLES]. In-game content available for use in such online games includes access to “pay-only” play levels and virtual in-game tools for use in playing an online game.

Access Codes for Downloadable Video Games as well as Associated Add-on Map Packs and Play Levels

Retail consumers purchase prewritten software in the form of complete video games or video game add-ons, which are delivered electronically via download directly to the customer’s personal computer, gaming console, or mobile device. At its retail stores, the Taxpayer sells access codes [REDACTED], which allow its customers to access and download the software from a third party server. The Taxpayer also plans to sell access codes via its website; in such cases, the customers will print out or otherwise record the codes for later use. Examples of items in this category are the download of video games currently offered on disc in a retail store, such as [EXAMPLES]. Further examples include the download of add-on map packs and play levels that are only available online and that may be integrated into a previously purchased video game, such as [EXAMPLES].

Notional Dollar Value Cards

Retail consumers purchase plastic cards containing notional dollar values to be used within online networks for game play, interaction among other players on a network, access to digital online content, or the direct download of digital content to a customer’s device. The Taxpayer sells plastic cards containing notional dollar values that allow the customer to access content on a third party network for a specified number of points. Cards offering points may provide network access for a period of time, be used to access digital content on the network, or be used to directly download digital content from the network. An example of an item in this category is the [EXAMPLE].

¹ To the Taxpayer’s knowledge, no third party servers are located in Tennessee.

Points Cards

Retail consumers purchase plastic cards containing point values to be used within online networks for game play, interaction among other players on a network, access to digital online content, and/or the direct download of digital content to a customer's device. The Taxpayer sells plastic cards containing points that allow the customer to access content on a third party network for a specified number of points. Cards offering points may provide network access for a period of time, be used to access digital content on the network, or be used to directly download digital content from the network. An example of an item in this category is the [EXAMPLE] card.

Subscription Cards

Retail consumers purchase plastic cards containing subscription time to be used to access online networks that allow game play, interaction among other players on a network, access to online digital content, and/or the direct download of digital content to a customer's device. The Taxpayer sells plastic cards containing a subscription that allows the customer to access a third party network or content on a third party network for a specified period of time. Cards offering subscriptions may provide network access for a period of time, be used to access digital content on the network, or be used to directly download digital content from the network. An example of an item in this category is the [EXAMPLES] subscription card. Non-gaming examples include [EXAMPLES].

RULINGS

1. Are the Taxpayer's retail sales of access codes for remotely accessed software and virtual goods subject to the Tennessee sales and use tax?

Ruling: No, retail sales of access codes for remotely accessed software and virtual goods are not subject to the Tennessee sales and use tax. No sale occurs in Tennessee because customers remotely access games located on servers outside of Tennessee and do not download the software or virtual goods to their computers.

2. Are the Taxpayer's retail sales of codes for downloadable video games as well as for add-on map packs and play levels subject to the Tennessee sales and use tax?

Ruling: Yes, retail sales of codes for downloadable video games as well as for add-on map packs and play levels are subject to the Tennessee sales and use tax. The purchase of this type of access code is equivalent to a payment for downloaded computer software.

3. Are the Taxpayer's retail sales of notional dollar value cards and points cards subject to the Tennessee sales and use tax?

Ruling: No, retail sales of notional dollar value cards and points cards, like gift cards, are not subject to the Tennessee sales and use tax.

4. Are the subscription cards subject to the Tennessee sales and use tax?

Ruling: The taxability of a subscription card depends upon the particular card's designated use. If a card's designated use is only for remote access to software without download, the card is not subject to the Tennessee sales and use tax. If a card is designed for a customer to 1) remotely access specified digital products, 2) download specified digital products, or 3) download computer software, it is subject to the sales and use tax. If a card's design gives a customer the ability to remotely access software as well as the ability to remotely access or download specified digital products or to download computer software, the entire purchase price of the card is subject to the sales and use tax as a bundled transaction.

ANALYSIS

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

TENN. CODE ANN. § 67-6-102(78)(A) (Supp. 2012) defines "sale" in pertinent part to mean "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." "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."⁴ 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."⁵ 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.⁶

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).

⁴ TENN. CODE ANN. § 67-6-102(89)(A).

⁵ TENN. CODE ANN. § 67-6-102(68) further provides that "[p]re-written 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).

⁶ 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).

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.⁷ 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.⁸

“Computer software” is “a set of coded instructions designed to cause a computer . . . to perform a task.”⁹ Computer software is “delivered electronically” if delivered “by means other than tangible storage media.”¹⁰

Another “thing” subject to the sales and use tax is the “retail sale, lease, licensing or use of specified digital products transferred to or accessed by subscribers or consumers” in Tennessee.¹¹ “Specified digital products” is defined as “electronically transferred digital audio-visual works, digital audio works and digital books.”¹²

The sales tax also applies to retail 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.¹³ “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.”

There are two ways that non-enumerated services, however, may be included in the sales price of a given transaction, despite not being directly subject to tax. First, a nontaxable service or item may be subject to taxation when charges for the nontaxable service or item are included in the sales price of a taxable good or service. Specifically, TENN. CODE ANN. § 67-6-102(79)(A) provides that the sales price of a good or service equals the “total amount of consideration . . . for which personal property or services are sold.” Thus, if taxable goods or services and nontaxable goods or services are sold together for a single charge, the entire charge is generally subject to taxation, with the bundled sales price as the measure of tax.

⁷ TENN. CODE ANN. § 67-6-102(78)(C).

⁸ TENN. CODE ANN. § 67-6-231(a) (2013) (emphasis added).

⁹ TENN. CODE ANN. § 67-6-102(18).

¹⁰ TENN. CODE ANN. § 67-6-102(24).

¹¹ TENN. CODE ANN. § 67-6-233(a) (2013).

¹² TENN. CODE ANN. § 67-6-102(86).

¹³ See TENN. CODE ANN. § 67-6-205(c)(3) (2013).

The second manner in which a non-enumerated service will be included in the sales price of a transaction is where the service is intertwined with the sale of taxable tangible personal property. The definition of “sales price” provides in pertinent part that there will be no deductions for “labor or service” cost by the seller and also includes “[c]harges by the seller for any services necessary to complete the sale, other than delivery and installation charges.”¹⁴

Accordingly, the Taxpayer’s activities will be subject to the Tennessee sales tax if its charges relate to: 1) the sale of tangible personal property, specified digital products, or computer software in Tennessee; 2) the furnishing of a taxable service, including a telecommunications service, in Tennessee; 3) the furnishing of an otherwise nontaxable good or service that is bundled with a taxable good or service; and/or 4) the furnishing of a non-enumerated service that is a “crucial,” “essential”, or “integral” element of a transaction that involves that sale of taxable tangible personal property, or vice versa.

1. Access Codes for Remotely Accessed Software/Virtual Goods

The sale of access codes for remotely accessed software and virtual goods is not subject to the Tennessee sales and use tax.

First, no sale or transfer of tangible personal property, including prewritten computer software, occurs when the Taxpayer furnishes the code for remotely accessed software or virtual goods. The Taxpayer sells codes that its customers use to access information on a web based interface stored on servers located outside of Tennessee in order to play video games. The Taxpayer’s customer does not download anything to his or her computer. The Taxpayer does not transfer title, possession, or control of the interface to the customer at any time. As such, the interface is never delivered to, transferred to, or installed on the customer’s computers, but remains on the Taxpayer’s servers located outside of Tennessee.

Second, the Taxpayer’s provision of remotely accessed software and virtual goods does not constitute the furnishing of a taxable service in Tennessee for purposes of the Tennessee sales and use tax.

Third, because the Taxpayer does not make sales of taxable goods or services in conjunction with the sale of the remote access codes, the sale of such service cannot be characterized as the furnishing of an otherwise nontaxable service that is sold as part of the sale of a taxable good or service.¹⁵ Fourth, analysis under the principles set forth in the *Crescent* line of cases¹⁶ is unnecessary because the Taxpayer does not sell any item of tangible personal property with the access codes.

¹⁴ TENN. CODE ANN. § 67-6-102(79)(A).

¹⁵ See TENN. CODE ANN. § 67-6-102(79)(A).

¹⁶ See *supra* note 6.

Accordingly, the Taxpayer's access codes for remote access software and virtual goods codes are not subject to the Tennessee sales and use tax.

2. Access Codes for Downloadable Video Games as well as Add-on Packs and Play Levels

The Taxpayer's sale of access codes for downloadable video games as well as downloadable add-on map packs and play levels is subject to the Tennessee sales and use tax.

As stated above, one of the "things" subject to the sales and use tax is the sale of computer software, including prewritten computer software, in Tennessee.¹⁷ The video games, add-on map packs, and play levels that customers may download with access codes fit within the definition of computer software as "a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task"; namely, the several tasks necessary for a video game system to display and operate a video game.¹⁸ It is immaterial that the customer downloads the software electronically.¹⁹ The sale of this type of access code differs from the sale of an access code for remotely accessed software and virtual goods because the access codes at issue here allow the Taxpayer's customer to download computer software directly to his or her computer.

The fact that a customer is purchasing an access code rather than actual computer software is also inconsequential because the purchase of an access code is simply a delayed possession of the specific product that a customer must download. Thus, when a customer purchases an access code for downloadable digital content, that purchase is akin to the purchase of computer software.

Accordingly, the sale of access codes for downloadable digital content is subject to the sales and use tax.

3. Notional Dollar Value Cards and Points Cards

The Taxpayer's notional dollar value cards and points cards are treated like gift cards and are not taxable at the time of their sale.

When the Taxpayer sells notional dollar value cards and points cards, there is technically an exchange of title or possession of tangible personal property for consideration.²⁰ The physical medium of the cards themselves can be characterized as tangible personal property in that a customer can feel or touch the cards.²¹ However, the true object of the sale of such a card is not

¹⁷ TENN. CODE ANN. § 67-6-231(a) (2013)

¹⁸ See TENN. CODE ANN. § 67-6-102(18).

¹⁹ See TENN. CODE ANN. § 67-6-231(a) (sale or use of computer software in this state is taxable "regardless of whether the software is delivered electronically").

²⁰ See TENN. CODE ANN. § 67-6-102(78)(A).

²¹ See TENN. CODE ANN. § 67-6-102(89)(A).

the sale of tangible personal property in the form of a card, but rather the granting to a customer of an intangible right.²² The card itself has no value, in and of itself, but contains notional dollar values or point values to be exchanged for either network access to digital content or the direct download of digital content from a network. Because the true object of the transaction is the granting to a customer an intangible right, the transaction will be treated for sales tax purposes as though no sale or transfer of tangible personal property, including prewritten computer software, has occurred.²³ Thus, the Taxpayer does not need to collect sales tax on the sale of notional dollar value cards or points cards.

A customer's use of a notional dollar value card or points card dictates when and to what extent a taxable sale occurs. Typically, a customer will redeem the card and apply the dollar or points value to his or her account. The customer may then use that value to remotely access digital content or to download digital content. If a customer uses dollar value or points to download computer software or specified digital products or to electronically access specified digital products, the sales tax applies to the dollar value used or dollar value equivalent of points used, whether wholly or partially funded by a notional dollar value card or a points card, at the time of that particular download.²⁴ The seller of the computer software being downloaded or the seller of the specified digital products downloaded or accessed should charge sales tax on such sale.²⁵

On the other hand, if a customer uses the value from a notional dollar value or points card to access software via the Internet without downloading it, the purchase price of that access is not subject to the sales and use tax, and the recipient of the value from the card need not collect the sales tax on the transaction.

4. Subscription Cards

Whether the sales and use tax applies to the Taxpayer's sale of subscription cards depends upon the intended use of a particular card, as explained below.

²² Cf. *Barnes & Noble Superstores, Inc. v. Huddleston*, No. 01A01-9604-CH-00149, 1996 WL 596955, at *2 (Tenn. Ct. App. Oct. 18, 1996) (holding that the sale of discount club memberships is not subject to sales tax because the "true object" of the transaction is to "bestow upon club members the intangible right to receive a discount on merchandise").

²³ Similarly, there is no furnishing of a taxable service that occurs when the Taxpayer provides a customer with this intangible right, nor is there a taxable good or service bundled in the same transaction as the sale of the intangible right, and analysis under the principles set forth in the *Crescent* line of cases is unnecessary because the Taxpayer does not sell any item of tangible personal property with the access codes. See *supra* note 6; TENN. CODE ANN. § 67-6-102(79)(A).

²⁴ See TENN. CODE ANN. §§ 67-6-231(a), 67-6-233(a).

²⁵ The seller of the computer software being downloaded or the seller of specified digital products downloaded or accessed is required by law to collect Tennessee sales tax on its sales to customers in Tennessee. If the seller of the computer software or specified digital products fails to collect Tennessee sales tax, the customer will be liable for the Tennessee use tax on his or her download of computer software or specified digital products or access to specified digital products.

The Taxpayer sells subscription cards for a variety of purposes. Some cards provide access to online digital networks while others allow a customer to download content to his or her computer. Still other cards have both functions and allow a customer to access content online as well as to download content.

If the sole purpose of a subscription card is for a customer to remotely access specified digital products or to download computer software or specified digital products, the sale of that card is subject to the sales and use tax. With regard to subscription cards for the download of software, the card is a physical manifestation of the right to electronically download computer software, which is tangible personal property, and the card represents the delayed possession of the tangible personal property that a customer will download.²⁶ An example of this type of transaction would be the purchase of a subscription card for the download of [EXAMPLES], which are considered computer software.²⁷ In addition, TENN. CODE ANN. § 67-6-233(b)(3) provides that subscriptions for receiving or accessing specified digital products are subject to the sales and use tax. An example of this type of subscription card would be one for [EXAMPLE], a service that allows customers to [STREAM SPECIFIED DIGITAL PRODUCTS].²⁸

On the other hand, if the sole purpose of a subscription card is for a customer to remotely access video games, which are computer software, the sale of a subscription card is not subject to the sales and use tax because there is no sale, transfer, or electronic delivery of tangible personal property, including prewritten computer software, which occurs in Tennessee. The Taxpayer sells these subscription cards so that its customers can access information on a web based interface stored on servers located outside of Tennessee in order to play video games. The customer does not download anything to his or her computer, and the Taxpayer does not transfer title, possession, or control of the interface to the customer at any time. As such, the interface is never delivered to, transferred to, or installed on the customer's computer but remains on the Taxpayer's servers located outside of Tennessee. Information or data accessed over the Internet is not considered the transfer of tangible personal property in Tennessee.

If a subscription card, however, allows a customer to both remotely access computer software as well as to electronically access or download specified digital products or download computer software to his or her computer, the Taxpayer is selling both taxable and nontaxable goods or services together for a single charge. In that case, the entire bundled sales price of the subscription card is subject to taxation.²⁹ An example of this type of card would be an [EXAMPLE] subscription card, which allows users to access and download a variety of content, including [EXAMPLES].³⁰

²⁶ See TENN. CODE ANN. §§ 67-6-102(18), -231(a), -233(a).

²⁷ [REDACTED].

²⁸ [REDACTED].

²⁹ See TENN. CODE ANN. § 67-6-102(79)(A).

³⁰ [REDACTED].

Thus, if the sole purpose of a subscription card is to for a customer to remotely access video games, then the sale of the subscription card will not be subject to Tennessee sales tax. However, the sale of any subscription card that could potentially authorize a customer to download video games or to access or download specified digital products would be subject to the Tennessee sales tax.

Conclusion

In conclusion, retail sales of access codes for remotely accessed software and virtual goods are not subject to the sales and use tax. Retail sales of access codes for downloadable video games as well as for add-on map packs and play levels are subject to the sales and use tax. Retail sales of notional dollar value cards and points cards are treated like gift cards and not subject to the sales and use tax. The taxability of a subscription card depends upon the particular card's designated use. If a card's designated use is only for remotely accessed software without download, the card is not subject to the sales and use tax. If a card is designed for a customer to 1) remotely access specified digital products, 2) download specified digital products, or 3) download computer software, it is subject to the sales and use tax. If a card's design gives a customer the ability to remotely access software as well as the ability to remotely access or download specified digital products or to download computer software, the entire purchase price of the card is subject to the sales and use tax as a bundled transaction.

Jennifer Wilson
Assistant General Counsel

APPROVED: Richard H. Roberts
Commissioner of Revenue

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