

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 15-08**

**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**

Application of the Tennessee sales and use tax to remotely accessed software.

**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**

[REDACTED – TAXPAYER'S NAME] (the "Taxpayer") is a Tennessee-based provider of various [REDACTED – SERVICES] to [REDACTED – TYPES OF CLIENTS]. The Taxpayer operates [REDACTED] data centers in Tennessee and provides services to customers through its affiliates located both

inside and outside of Tennessee. The Taxpayer's services allow its customers to more effectively manage [REDACTED – PROCESSES]. The relevant affiliates providing these services are listed below:

[REDACTED].

### **Specific Service Offerings**

The Taxpayer's service offerings integrate and automate key business and administrative functions of [CUSTOMERS] [REDACTED]. The specific services (the "Service Offerings") that the Taxpayer provides to its customers include its [INFORMATION MANAGEMENT SERVICE], [REMOTE STORAGE SERVICE], [ELECTRONIC DELIVERY SERVICE], [PAYMENT MANAGEMENT SERVICE], [SERVICE FOR REDACTED CUSTOMER], and [WEB-BASED INFORMATION SERVICE].

#### **1. [INFORMATION MANAGEMENT SERVICE]**

Through its [INFORMATION MANAGEMENT SERVICE], the Taxpayer processes [REDACTED] transactions on behalf of [CUSTOMERS]. The Taxpayer's [INFORMATION MANAGEMENT SERVICE] includes a [VARIOUS TYPES OF INFORMATION SERVICES]. Through its [INFORMATION CONNECTION SERVICE], the Taxpayer provides [CONNECTION SERVICE] to customers for [INFORMATION] transactions. With this service, [REDACTED] are able to directly connect to the Taxpayer's [REDACTED] through the Taxpayer's [DATA SERVICE] solutions so as to directly submit [INFORMATION] [REDACTED]. Additionally, as part of this service, the Taxpayer provides customers with value-added transaction editing so that processing of the transactions is more accurate and efficient and the need for resubmissions is reduced. The Taxpayer's [INFORMATION MANAGEMENT SERVICE] streamlines [REDACTED – PROCESSES] and makes [REDACTED] transactions more efficient for customers. The Taxpayer typically charges customers [VARIOUS FEES].

The Taxpayer also provides a [REDACTED – SERVICE] by which it processes [REDACTED – INFORMATION] and applies predefined rules to ensure the [INFORMATION] is processed accurately upon first pass. During [REDACTED – INFORMATION] processing, the Taxpayer validates and corrects [REDACTED] data within the [REDACTED – INFORMATION] to improve the accuracy of the [REDACTED – INFORMATION].

#### **2. [REMOTE STORAGE SERVICE]**

Through its [REMOTE STORAGE SERVICE], the Taxpayer stores [DOCUMENTS] that it prepares and delivers to recipients on behalf of its customers. Customers may access the [DOCUMENTS] through an online portal. The Taxpayer charges customers a fee for the online storage of [DOCUMENTS].

#### **3. [ELECTRONIC DELIVERY SERVICE]**

Through its [ELECTRONIC DELIVERY SERVICE], the Taxpayer electronically delivers individualized [REDACTED] documents [REDACTED], which it prepares using customer-provided data, to intended recipients on behalf of its customers. As part of this service, the Taxpayer designs and develops a [REDACTED] portal that allows individuals to elect to receive electronic document communications in lieu of physical document delivery. The Taxpayer develops a [REDACTED – CUSTOMER PORTAL] that

allows the customer to view the status of document preparation and delivery. The Taxpayer charges its customers a [REDACTED - FEE] for the Taxpayer to configure its system in order to process the customer-supplied data. The Taxpayer also charges customers a [REDACTED - FEE].

#### *4. [PAYMENT MANAGEMENT SERVICE]*

Through its [PAYMENT MANAGEMENT SERVICE], the Taxpayer processes [REDACTED] payment transactions on behalf of [CUSTOMERS]. To do so, the Taxpayer's customers provide the Taxpayer with electronic files from the customers' systems with data necessary for the Taxpayer to process these payment transactions. The Taxpayer utilizes [ELECTRONIC APPLICATIONS] and the customer supplied data to process [INFORMATION AND PAYMENTS] both electronically and on paper. Specifically, the Taxpayer's [PAYMENT MANAGEMENT SERVICE] includes [REDACTED - NON-TAXABLE SERVICES].

[REDACTED].

Finally, the Taxpayer offers customers access to its web-based [CUSTOMER ACCESS SYSTEM] and charges customers for this access based on the number of transactions processed. The [CUSTOMER ACCESS SYSTEM] allows payers to have visibility of payment documentation from the time the Taxpayer receives the data until the payment is delivered to the recipient. Through this system, customers can access [INFORMATION AND REPORTS]. Additionally, customers can revise the customer specific business rules that govern how the Taxpayer processes and delivers the payments for each customer. Customers can also use the [CUSTOMER ACCESS SYSTEM] to locate [REDACTED - INFORMATION AND TRANSACTIONS] and payments with user-defined search criteria.

#### *5. [SERVICE FOR REDACTED CUSTOMER]*

Through its [SERVICE FOR SPECIFIC CUSTOMER], the Taxpayer processes various [REDACTED] transactions for [REDACTED - CUSTOMERS]. The Taxpayer utilizes [REDACTED - APPLICATIONS] to provide this service, which includes:

[REDACTED NON-TAXABLE SERVICES]

The Taxpayer typically charges customers [REDACTED FEE].

In addition to the services above, customers may purchase access to the Taxpayer's web-based system that allows customers to access online tools to [MONITOR AND TRACK INFORMATION AND REPORTS]. The Taxpayer charges customers [REDACTED FEE] for access to this system.

#### *6. [WEB-BASED INFORMATION SERVICE]*

The Taxpayer provides a [WEB-BASED INFORMATION SERVICE] to [CUSTOMERS] that allow the employees and [REDACTED] (the "user(s)") of these customers, respectively, to access the web-based [REDACTED] information portal, using individual log-in information, to search for and view user specific information on [REDACTED - INFORMATION]. Such information allows the users to make informed [REDACTED] decisions on [REDACTED]. This ultimately results in savings for the Taxpayer's customers [REDACTED]. As part of the set-up of this service for each customer, the Taxpayer is

provided customer-unique data so that the information the Taxpayer provides with this service is specific to each unique customer and user. The Taxpayer charges its customers [REDACTED - FEES].

### **Sales of Stand-Alone Software**

In addition to the services discussed above, the Taxpayer also sells to customers a license allowing those customers to remotely access stand-alone software that the Taxpayer historically delivered via tangible means. In some instances, the Taxpayer provides this software to customers who use the software in Tennessee, as well as other states. The locations of these users differ by customer and may change, by customer, year over year. In addition, the Taxpayer may sell remote access to different applications to a single customer that has a different number of Tennessee-based users depending on the particular application.

On its customer invoices, the Taxpayer separately itemizes the charge for software or remote access to software. The invoices may include a "bill to" or "ship to" address that may or may not correlate to the location where the users of the software are located.

### **The Taxpayer's Access and Use of Software**

In providing the services discussed above, the Taxpayer uses and consumes software that it purchases and acquires through physical or electronic means or that it accesses remotely. The Taxpayer also develops and uses proprietary custom software applications to provide its services to customers. Some of the software purchased and remotely accessed by the Taxpayer may be used in Tennessee as well as other states, though it is purchased in a single transaction. Invoices for the Taxpayer's purchases of such software may include a "bill to" or "ship to" address unrelated to the actual location of the software users.

## **RULINGS**

1. Are the Taxpayer's charges for any of its Service Offerings subject to the Tennessee sales and use tax?

Ruling: No. None of Taxpayer's Service Offerings are subject to the Tennessee sales and use tax.

2. Is the Taxpayer required to collect Tennessee sales tax on its sales of remotely accessed software to customers with users both within and without Tennessee?

Ruling: For billing periods that begin on or after July 1, 2015, the Taxpayer generally must collect Tennessee sales tax on the sales price of remotely accessed software used by a customer in Tennessee. A customer may, however, present to the Taxpayer a Remotely Accessed Software Direct Pay Permit stating that the customer has users outside of Tennessee and will remit tax directly to the Department. In such instance, the Taxpayer is no longer responsible for collecting sales tax on the transaction. Alternatively, a customer may present the Taxpayer with a fully completed Streamlined certificate of exemption at the time of purchase to exclude the portion of the sales price that corresponds to its percentage of

users located outside Tennessee, and pay the tax based on its percentage of users located inside of Tennessee.

3. Is the Taxpayer required to remit Tennessee sales tax on its purchases of remotely accessed software used by persons located inside and outside of Tennessee?

Ruling: The Taxpayer may present the seller with a Remotely Accessed Software Direct Pay Permit at the time of purchase and remit sales tax directly to the Department on the portion of the sales price that corresponds to the percentage of its users located inside Tennessee. Alternatively, the Taxpayer may present the seller with a fully completed Streamlined certificate of exemption at the time of purchase to exclude the portion of the sales price that corresponds to its percentage of users located outside Tennessee, and pay the tax based on its percentage of users located inside of Tennessee.

## ANALYSIS

### 1. TAXATION OF SOFTWARE AND SERVICES

#### A. BACKGROUND

Under the Retailers' Sales Tax Act,<sup>1</sup> the retail sale in Tennessee of tangible personal property and specifically enumerated 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."<sup>2</sup>

TENN. CODE ANN. § 67-6-102(78)(A) (Supp. 2015) 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 "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."<sup>3</sup>

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

<sup>2</sup> TENN. CODE ANN. § 67-6-102(76) (Supp. 2015).

<sup>3</sup> 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." TENN. CODE ANN. § 67-6-102(89)(A).

With regard to prewritten computer software, TENN. CODE ANN. § 67-6-102(68) 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),

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.<sup>4</sup> 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.<sup>5</sup>

“Computer software” is “a set of coded instructions designed to cause a computer . . . to perform a task.”<sup>6</sup> Computer software is “delivered electronically” if delivered “by means other than tangible storage media.”<sup>7</sup> The Tennessee Supreme Court has stated that the fabrication of, or customized modification or enhancement to, computer software is considered a taxable sale of computer software.<sup>8</sup>

Additionally, the term “sale” specifically includes the transfer of computer software, including the creation of computer software on the premises of the consumer and any programming, transferring, or loading of computer software onto a computer.<sup>9</sup>

In response to advances in technology that allow persons to remotely access and use software over the Internet, the Tennessee General Assembly adopted into law 2015 Tenn. Pub. Acts Ch. 514, § 22 (effective July 1, 2015). This new law effectively treats all purchases of computer software in this state equally, regardless of how the software is provided to and used by a purchaser in this state. It amends TENN. CODE ANN. § 67-6-231(a) to include a new subdivision (2), which states in pertinent part that

[f]or purposes of subdivision (a)(1), “use of computer software” includes the access and use of software that remains in the possession of the dealer who provides the software or in the possession of a third party on behalf of such dealer. If the customer accesses the software from a location in this state as indicated by the residential street address or the primary business address of the customer, such access shall be deemed equivalent to the sale of licensing of the software and electronic delivery of the software for use in the state.<sup>10</sup>

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<sup>4</sup> TENN. CODE ANN. § 67-6-102(78)(C).

<sup>5</sup> TENN. CODE ANN. § 67-6-231(a)(1) (Supp. 2015). The term “sale” specifically includes the transfer of computer software, including the creation of computer software on the premises of the consumer and any programming, transferring, or loading of computer software onto a computer. TENN. CODE ANN. § 67-6-102(78)(K).

<sup>6</sup> TENN. CODE ANN. § 67-6-102(18).

<sup>7</sup> TENN. CODE ANN. § 67-6-102(24).

<sup>8</sup> See *Creasy Sys. Consultants, Inc. v. Olsen*, 716 S.W.2d 35, 36 (Tenn. 1986).

<sup>9</sup> TENN. CODE ANN. § 67-6-102(78)(K).

<sup>10</sup> 2015 Tenn. Pub. Acts Ch. 514, § 22 (codified at TENN. CODE ANN. § 67-6-231(a)(2) (Supp. 2015)).

As a result, effective for all billing periods beginning on or after July 1, 2015, the access and use of computer software in this state, which has generally been subject to tax since 1977,<sup>11</sup> remains subject to sales and use tax regardless of a customer's chosen method of use.

The sales tax also applies to retail sales of services specifically enumerated in the Retailers' Sales Tax Act.<sup>12</sup> The furnishing of "intrastate, interstate or international telecommunication services" is one such specifically enumerated service.<sup>13</sup> "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." TENN. CODE ANN. § 67-6-102(90)(B)(i) excludes from the definition of "telecommunications service," however, "[d]ata processing and information services that allow data to be generated, acquired, stored, processed, or retrieved and delivered by electronic transmission to a purchaser, where such purchaser's primary purpose for the underlying transaction is the processed data or information."

Notably, the application of the sales tax to retail sales of services in Tennessee remains unaffected by the enactment of 2015 Tenn. Pub. Acts Ch. 514, § 22. The sales tax remains applicable only to those services specifically enumerated in the Retailers' Sales Tax Act.<sup>14</sup> As reassurance of this fact, the General Assembly included language in Section 22 stating that nothing in the new subdivision (a)(2) of TENN. CODE ANN. § 67-6-231

shall be construed to impose a tax on any services that are not currently subject to tax under this chapter, such as, but not limited to, information or data processing services, including the capability of the customer to analyze such information or data provided by the dealer; payment or transaction processing services; payroll processing services; billing and collection services; Internet access; the storage of

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<sup>11</sup> The General Assembly amended the definition of "tangible personal property" in 1977 to specifically include computer software in response to the Tennessee Supreme Court's holding to the contrary in *Commerce Union Bank*, 538 S.W.2d at 408. 1977 Tenn. Pub. Acts Ch. 42 (defining "tangible personal property" to include computer software); see also *Univ. Computing Co. v. Olsen*, 677 S.W.2d 445, 447 (Tenn. 1984) (detailing the General Assembly's actions taken to subject computer software to sales and use tax).

<sup>12</sup> The Retailers' Sales Tax Act imposes the sales tax only on services specifically enumerated in the Act. See, e.g., TENN. CODE ANN. § 67-6-205 (2013); *Covington Pike Toyota, Inc. v. Cardwell*, 829 S.W.2d 132, 135 (Tenn. 1992); *Ryder Truck Rental, Inc. v. Huddleston*, No. 91-3382-III, 1994 WL 420911, at \*3 (Tenn. Ct. App. Aug. 12, 1994) (sales tax does not apply to all services; rather, it only applies to retail sales of services specifically enumerated by the statute).

<sup>13</sup> TENN. CODE ANN. § 67-6-205(c)(3) (2013).

<sup>14</sup> The Retailers' Sales Tax Act imposes the sales tax only on services specifically enumerated in the Act. See, e.g., TENN. CODE ANN. § 67-6-205; *Covington Pike Toyota, Inc. v. Cardwell*, 829 S.W.2d 132, 135 (Tenn. 1992); *Ryder Truck Rental, Inc. v. Huddleston*, No. 91-3382-III, 1994 WL 420911, at \*3 (Tenn. Ct. App. Aug. 12, 1994) (sales tax does not apply to all services; rather, it only applies to retail sales of services specifically enumerated by the statute).

data, digital codes, or computer software; or the service of converting, managing, and distributing digital products.<sup>15</sup>

Therefore, while the new TENN. CODE ANN. § 67-6-231(a)(2) modernizes taxation of computer software in this state, it has no effect on the taxation of services.

Additionally, whenever two or more items are sold for a single sales price and at least one of the items is subject to sales tax, the entire sales price is subject to sales tax as a bundled transaction.<sup>16</sup> Finally, when a transaction involves taxable and nontaxable components and the transaction's true object or a "crucial,"<sup>17</sup> "essential,"<sup>18</sup> "necessary,"<sup>19</sup> "consequential,"<sup>20</sup> or "integral"<sup>21</sup> element of the transaction is subject tax, the entire transaction is subject to sales tax.<sup>22</sup> Only if the true object of the transaction is not independently subject to sales tax and the items that would be subject to sales tax are "merely incidental" to the true object of the transaction will the transaction not be subject to sales tax.<sup>23</sup>

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<sup>15</sup> 2015 Tenn. Pub. Acts Ch. 514, § 22 (codified at TENN. CODE ANN. § 67-6-231(a)(2) (Supp. 2015)).

<sup>16</sup> See generally Tenn. Dept. of Rev. Ltr. Rul. 14-10 (Oct. 14, 2014) [hereinafter "Ltr. Rul. 14-10"] (discussing Tennessee law regarding bundling and the "true object" test), available at <http://www.tennessee.gov/assets/entities/revenue/attachments/14-10.pdf>.

<sup>17</sup> See, e.g., *Thomas Nelson, Inc. v. Olsen*, 723 S.W.2d 621, 624 (Tenn. 1987) (holding that a transaction involving the sale of non-taxable intangible advertising concepts was nevertheless subject to sales tax on the entire amount of the transaction because advertising models, which were tangible personal property, were an "essential," "crucial," and "necessary" element of the transaction).

<sup>18</sup> *Id.*; see also *AT&T Corp. v. Johnson*, No. M2000-01407-COA-R3-CV, 2002 WL 31247083, at \*8 (Tenn. Ct. App. Oct. 8, 2002) (holding that a transaction involving the sale of engineering services along with separately itemized tangible telecommunications systems was subject to sales tax on the entire amount of the contract because "equipment, engineering, and installation combine in this instance to produce BellSouth's desired result: a functioning item of tangible personal property assembled on the customer's premises," and further describing the engineering services as "essential" and "integral" to the sale of tangible personal property).

<sup>19</sup> See *supra* note 18.

<sup>20</sup> See *Rivergate Toyota, Inc. v. Huddleston*, No. 01A01-9602-CH-00053, 1998 WL 83720, at \*4 (Tenn. Ct. App. Feb. 27, 1998) (holding that a transaction involving the commission and distribution of advertising brochures was subject to sales tax on the "entire cost of the transaction" because, although the transaction involved a number of services, the brochures themselves "were not inconsequential elements of the transaction but, in fact, were the sole purpose of the contract").

<sup>21</sup> See *AT&T Corp. v. Johnson*, 2002 WL 31247083, at \*8.

<sup>22</sup> See generally *Ltr. Rul. No. 14-10*, *supra* note 16.

<sup>23</sup> See generally *id.*



## **B. APPLICATION TO THE TAXPAYER**

As described, the Taxpayer provides a variety of Service Offerings related to its business of selling [REDACTED – SERVICES] to [CUSTOMERS]. The Tennessee sales and use tax treatment of each product offering is discussed below.

### *[INFORMATION MANAGEMENT SERVICE]*

The Taxpayer's [INFORMATION MANAGEMENT SERVICE] is not subject to the Tennessee sales and use tax.

Through its [INFORMATION MANAGEMENT SERVICE], the Taxpayer connects [CUSTOMERS] using [ELECTRONIC PROCESS] and provides transaction editing to create streamlined and efficient [INFORMATION] processing. In the [REDACTED – SERVICE], the Taxpayer applies predefined rules to ensure [INFORMATION] is processed accurately.

No sale or transfer of tangible personal property or computer software occurs in Tennessee when the Taxpayer provides this service. The Taxpayer is not a provider of and the customers are not purchasers of computer software in this instance. Rather, the Taxpayer uses computer software to provide [REDACTED] editing and [INFORMATION] processing services. Customers purchase the [INFORMATION MANAGEMENT SERVICE] for the primary purpose of obtaining these services - the true objects of the transaction. The software accessed by customers through the Taxpayer's [ELECTRONIC PROCESS] to submit [REDACTED] is merely incidental to the Taxpayer's provision of services.

Furthermore, the [INFORMATION MANAGEMENT SERVICE] does not constitute a taxable service for purposes of the Tennessee sales and use tax. As noted above, only specifically enumerated services are subject to tax under the Retailers' Sales Tax Act. Because the use of the [INFORMATION MANAGEMENT SERVICE] and its [ELECTRONIC PROCESS] involves the electronic transmission, conveyance, or routing of data between points, the service could potentially be characterized as a telecommunications service under TENN. CODE ANN. § 67-6-102(90)(A). TENN. CODE ANN. § 67-6-102(90)(B)(i), however, specifically excludes from the definition of "telecommunications service" any "[d]ata processing and information services that allow data to be generated, acquired, stored, processed, or retrieved and delivered by electronic transmission to a purchaser, where such purchaser's primary purpose for the underlying transaction is the processed data or information." The primary purpose of the Taxpayer's [INFORMATION MANAGEMENT SERVICE] is most accurately categorized as a transaction and data processing service. Accordingly, this service fits within the exclusion from the definition of a taxable telecommunications service as a data processing service. Thus, the provision of the [INFORMATION MANAGEMENT SERVICE] is not a taxable telecommunications service. Transaction and data processing services are not specifically enumerated taxable services and have been explicitly recognized by the Tennessee General Assembly as nontaxable services under TENN. CODE ANN. § 67-6-231(a)(2).

Accordingly, the Taxpayer's [INFORMATION MANAGEMENT SERVICE] is not subject to the Tennessee sales and use tax.

*[REMOTE STORAGE AND ELECTRONIC DELIVERY SERVICES]*

The Taxpayer's [REMOTE STORAGE AND ELECTRONIC DELIVERY SERVICES] are not subject to the Tennessee sales and use tax.

No sale or transfer of tangible personal property or computer software occurs in Tennessee when the Taxpayer provides access to this service. Furthermore, the storing and/or delivery of electronic images and documents are not specifically enumerated services and are nontaxable as data storage and data processing services, respectively, under TENN. CODE ANN. § 67-6-231(a)(2).<sup>24</sup>

The [REMOTE STORAGE AND ELECTRONIC DELIVERY SERVICES] also include online customer portals. The [REMOTE STORAGE SERVICE] comes with a portal that allows customers to access and view electronic images of documents. The [ELECTRONIC DELIVERY SERVICE] includes a portal allowing customers to elect to receive electronic documents and view the status of document preparation and delivery.

Software is used by the Taxpayer to operate these portals as delivery systems for its document archiving and delivery services. The Taxpayer's customers access the portal operating software only as an incidental medium for convenient transmission of the Taxpayer's nontaxable services. Customers engage in these transactions for the purpose of obtaining the Taxpayer's [REMOTE STORAGE AND ELECTRONIC DELIVERY SERVICES] – not for the purpose of accessing the Taxpayer's customer portal. Thus, the provision and use of software in this instance is merely incidental to the sale of the nontaxable services – the true objects of the transactions.

Accordingly, the Taxpayer's [REMOTE STORAGE AND ELECTRONIC DELIVERY SERVICE] is not subject to the Tennessee sales and use tax.

*[PAYMENT MANAGEMENT SERVICE]*

The Taxpayer's [PAYMENT MANAGEMENT SERVICE] is not subject to the Tennessee sales and use tax.

The [PAYMENT MANAGEMENT SERVICE] is comprised of several unique service offerings: [REDACTED – NON-TAXABLE SERVICES]. No sale or transfer of tangible personal property or computer software occurs in Tennessee when the Taxpayer provides access to these services.

Through its [REDACTED – NON-TAXABLE SERVICE] the Taxpayer prints or produces [REDACTED] statements or [INFORMATION] and delivers them to the intended recipient on behalf of the customer. This service is not specifically enumerated and is nontaxable under TENN. CODE ANN. § 67-6-231(a)(2) as a billing service.

Through its [ELECTRONIC PAYMENT SERVICE], the Taxpayer directs and distributes payments on behalf of its customers. Similarly, through its [ELECTRONIC STATEMENT SERVICE], the Taxpayer prepares and delivers electronic [STATEMENTS] on behalf of its customers. Neither of these services

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<sup>24</sup> The [ELECTRONIC DELIVERY SERVICE] is not taxable as a telecommunications service because data processing services are excluded from that definition under TENN. CODE ANN. § 67-6-102(90)(B)(i).

is specifically enumerated and both are nontaxable as transaction or data processing services under TENN. CODE ANN. § 67-6-231(a)(2).<sup>25</sup>

As part of its overall [PAYMENT MANAGEMENT SERVICE], the Taxpayer may also provide and separately charge customers for access to a web-based portal through which customers are able to track [REDACTED – INFORMATION] using user-defined search criteria. The portal and its underlying software used by the Taxpayer and accessed by customers simply allow customers a convenient means to access and review the product of the Taxpayer's [PAYMENT MANAGEMENT SERVICES]. Therefore, the portal is merely incidental to the nontaxable transaction or data processing services that make up the true object of the transaction.

Accordingly, the Taxpayer's [PAYMENT MANAGEMENT SERVICE] is not subject to the Tennessee sales and use tax.

*[SERVICE FOR REDACTED CUSTOMER]*

The Taxpayer's [SERVICE FOR REDACTED CUSTOMER] is not subject to the Tennessee sales and use tax.

The [SERVICE FOR REDACTED CUSTOMER] involves the provision of a variety of [REDACTED – NON-TAXABLE SERVICES]. Through these services, the Taxpayer processes [REDACTED] transactions on behalf of its [REDACTED CUSTOMERS] by reconciling [INFORMATION] with [TRANSACTIONS], providing [REDACTED – NON-TAXABLE SERVICES].

No sale or transfer of tangible personal property or computer software occurs in Tennessee when the Taxpayer provides access to these services. Furthermore, none of these services are taxable enumerated services and are each nontaxable under TENN. CODE ANN. § 67-6-231(a)(2) as data processing, payment, billing, or collection services.<sup>26</sup>

In addition to these services, the Taxpayer may provide and separately charge customers for access to a web-based portal through which customers can monitor and track [REDACTED – INFORMATION AND REPORTS]. Similar to the [TRANSACTION MANAGEMENT SERVICE] portal, this web-based portal used by the Taxpayer allows customers convenient access to view the product of the Taxpayer's nontaxable [SERVICE FOR REDACTED CUSTOMER]. Thus, the access of the portal by customers in Tennessee is merely incidental to the sale of nontaxable services.

Accordingly, the Taxpayer's [SERVICES FOR REDACTED CUSTOMER] are not subject to the Tennessee sales and use tax.

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<sup>25</sup> For this reason, the services are also excluded from the definition of telecommunication services under TENN. CODE ANN. § 67-6-102(90)(B)(i).

<sup>26</sup> Additionally, these services do not meet the definition of taxable telecommunications services under TENN. CODE ANN. § 67-6-102(90)(B)(i).

*[WEB-BASED INFORMATION SERVICE]*

The Taxpayer's [WEB-BASED INFORMATION SERVICE] is not subject to the Tennessee sales and use tax.

This service allows the [REDACTED] Taxpayer's customers to access an online portal that provides searchable user specific information on [REDACTED]. The portal developed by the Taxpayer is not transferred or electronically delivered to its customers. Through its organization and hosting of customer data on the online portal, the Taxpayer is providing a nontaxable service akin to hosting a website and managing a domain. The hosting and organizing of data is not a specifically enumerated service subject to Tennessee sales and use tax. Customers purchase this service to provide their employees and [REDACTED] with an efficient presentation of [REDACTED - INFORMATION] associated with the customers' own service offerings - not for access to the online portal. Thus, although remotely accessed software is a medium through which the Taxpayer provides this service, the provision of access to software is merely incidental to the nontaxable service - the true object of the transaction.

Accordingly, the Taxpayer's [WEB-BASED INFORMATION SERVICE] is not subject to the Tennessee sales and use tax.

**2 & 3. COLLECTION AND PAYMENT OF SALES AND USE TAX FOR REMOTELY ACCESSED SOFTWARE**

**A. COLLECTION OF TAX BY DEALERS**

Dealers making sales of tangible personal property or taxable items or services are generally liable for the payment of Tennessee sales and use tax on such sales.<sup>27</sup> For sales of remotely accessed software, a dealer generally must collect the tax on software used by the customer in Tennessee. However, a dealer will not be required to collect tax on a sale of remotely accessed software where it is not readily apparent to the dealer that the customer is using the software in Tennessee. Due to the nature of remotely accessed software, the dealer may not be aware that the software is used in Tennessee.

As discussed in more detail below, there are two additional situations in which a dealer is not required to collect some or all of the tax otherwise due on a sale of remotely accessed software. First, if a purchaser of remotely accessed software uses the software in Tennessee and other states and provides to the dealer a Remotely Accessed Software Direct Pay Permit, the dealer is relieved of the liability to collect and remit tax on the transaction. Alternatively, the dealer may accept a fully completed Streamlined certificate of exemption specifying the percentage of the sales price that is allocated to users outside of Tennessee. In that case, the dealer must collect tax from the customer only on the percentage of the sales price that is allocated to Tennessee. The seller is relieved of the liability to collect tax on the exempt portion of the sales price as reflected on the completed certificate. In either case, the seller must retain the appropriate form as part of its books and records and make it available for inspection and comparison to its sales and use tax return.<sup>28</sup>

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<sup>27</sup> TENN. CODE ANN. § 67-6-501(a) (2013); *see also* TENN. CODE ANN. § 67-6-102(23).

<sup>28</sup> TENN. CODE ANN. § 67-6-409(a)(4); TENN. COMP. R. & REGS. 1320-5-1-.78(1). Note that any seller failing to adhere to the requirements of TENN. CODE ANN. § 67-6-409 (2013) remains liable for any tax due on a transaction. *Id.* at (c);

It is the responsibility of the purchaser to accurately allocate multi-state software usage and retain records supporting that allocation. If it is determined that a purchaser improperly claimed an exemption, the purchaser is held liable for the tax, not the seller.<sup>29</sup>

## **B. PAYMENT OF TAX BY PURCHASERS**

If a person purchases remote access to software for use wholly within Tennessee, applicable sales tax on the transaction generally must be collected by the seller as discussed above.<sup>30</sup> However, if the seller does not collect the tax, the purchaser must remit tax directly to the Department.

Alternatively, a person might purchase remote access to software for use across several states in a single transaction. To ensure the purchaser pays Tennessee sales and use tax only on the portion of the sales price reflecting its access and use of software in Tennessee, 2015 Tenn. Pub. Acts Ch. 514, § 22 (codified at TENN. CODE ANN. § 67-6-231(a)(2) (Supp. 2015)), provides that

[i]f the sale price or purchase price of the software relates to users located both in this state and outside this state as indicated by a residential street or business address, the dealer or customer may allocate to this state a percentage of the sales price or purchase price that equals the percentage of users in this state.

To make this allocation, a purchaser of remotely accessed software must determine the number of persons accessing and using the remotely accessed software in this state and divide that number by the total number of persons represented in the transaction that are accessing and using the software everywhere. A purchaser should determine the location of each user, insofar as possible, by the user's primary residential street or business address at the time of sale. If the location of users is difficult to determine, a purchaser should use a reasonable and consistent method of allocation that accurately reflects the percentage of users in Tennessee based on its books and records at the time of sale. A purchaser must include any person for whom it has purchased access and use of the software in the calculation, regardless of any person's level of access or extent of use.

If the purchaser pays for access to software that will be used by individuals who are located in this state, and other individuals who are located outside this state (for example, the purchaser's employees), then the purchaser may allocate the sales price subject to Tennessee tax based on the percentage of its users located in Tennessee. The purchaser must maintain adequate records supporting the allocation percentage applied to any particular transaction. If a purchase is ongoing or recurring in nature, the purchaser must take reasonable steps to update its allocation percentage upon a material change in its user ratio.

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*see also* TENN. COMP. R. & REGS. 1320-5-1-78(2) (1974) (providing that sales not supported by exemption certificates shall be deemed retail sales). Furthermore, a seller will be held liable for the tax if it "fraudulently fail[s] to collect tax" or "solicit[s] a purchaser to participate in the unlawful claim of an exemption." TENN. CODE ANN. § 67-6-409(d).

<sup>29</sup> TENN. CODE ANN. § 67-6-409(b)(1).

<sup>30</sup> TENN. CODE ANN. § 67-6-502 (2013).

A purchaser may present to a seller a Remotely Accessed Software Direct Pay Permit and remit sales tax to the Department on the portion of the sales price that corresponds to the percentage of its users located in Tennessee at the time of sale. A seller is not obligated to collect and remit the applicable sales tax when a purchaser presents a Remotely Accessed Software Direct Pay Permit or when the seller is not on notice that the customer will be using the software in Tennessee. When a customer presents the seller with a fully completed Streamlined certificate of exemption,<sup>31</sup> a seller must collect and remit sales tax only on the portion of the sales price that corresponds to the percentage of the customer's users located in Tennessee.<sup>32</sup>

The following examples illustrate this allocation method:

B, a public relations firm operating in Tennessee and four other states, pays a yearly licensing fee to a vendor for remote access to graphic design software. B has 200 total employees accessing and using the software, twenty of which access and use the software in Tennessee. The seller bills B for the software at its Tennessee location. B is required to pay, and the seller is required to collect, Tennessee sales tax on one-hundred percent (100%) of the sales price unless B provides the seller with a Remotely Accessed Software Direct Pay Permit or a fully completed Streamlined certificate of exemption. If B provides a Remotely Accessed Software Direct Pay Permit, the seller is not required to collect tax, and B must remit tax to the Department on ten percent (10%) of the sales price. If B provides a Streamlined certificate of exemption, the seller must collect and B must pay tax on 10% of the sales price.

The facts are the same as above, except the seller bills B at a location outside Tennessee and is unaware that B uses the software in Tennessee. In this instance, the seller is not required to collect sales tax on the transaction. B must remit tax to the Department on ten percent (10%) of the sales price.

E is a building products manufacturer headquartered in Tennessee with operations in numerous other states. E pays a flat annual subscription fee to a vendor to access and use accounting software. All of the accountants accessing and using the software are located in E's Tennessee headquarters. Managers at E's manufacturing facility in Georgia and research and development facility in Texas have access and use the software for the sole purpose of running monthly reports. The managers in Georgia and Texas are users of the software for purposes of allocating the sales price.

G is an auto parts manufacturer with a billing department located in Tennessee and manufacturing facilities located in several other states. G pays a yearly licensing fee to a

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<sup>31</sup> The Streamlined certificate must include the customer's Tennessee sales and use tax registration number. In addition, on Line 5, "Reason for Exemption," the customer should circle "Other" with an explanation such as, "remote access software used by employees located in multiple states" and specify the percentage of users located outside of Tennessee.

<sup>32</sup> For additional information, see Sales and Use Tax Notice # 15-14, available at <http://tn.gov/assets/entities/revenue/attachments/sales15-14.pdf>, and Sales and Use Tax Notice # 15-24, available at <http://tn.gov/assets/entities/revenue/attachments/sales15-24.pdf>.

vendor for access and use of engineering software. Even though it may appear to the seller that G is using the software in Tennessee, only G's engineers located in other states access and use the software. Thus, G may provide the seller a Remotely Accessed Software Direct Pay Permit or a fully completed Streamlined certificate of exemption and pay no Tennessee sales and use tax on the transaction.

The facts are the same as above, except that G is now paying a yearly licensing fee to a vendor for access and use of financial software. G's personnel at its Tennessee billing department are the only persons accessing and using the software. G may not use a Remotely Accessed Software Direct Pay Permit for this transaction. G must pay, and the seller must collect and remit, Tennessee sales and use tax on the full sales price of the software license.

### **C. APPLICATION TO THE TAXPAYER**

#### *Sales of Software by the Taxpayer*

In addition to the various service offerings already discussed, the Taxpayer sells stand-alone software to its customers, including software that is remotely accessed via the Internet and used by persons in Tennessee. For any billing period beginning on or after July 1, 2015, the Taxpayer must collect Tennessee sales and use tax on all such sales to customers using the software in Tennessee. As discussed above, as the dealer of such software, the Taxpayer is generally responsible for collecting the sales and use tax due from its customers.<sup>33</sup> If the Taxpayer is on notice that the purchaser is using the software in Tennessee, the Taxpayer must collect Tennessee sales and use tax on the full retail sales price of the software at the time of sale unless the customer provides a Remotely Accessed Software Direct Pay Permit or a fully completed Streamlined certificate of exemption.<sup>34</sup> If the customer provides a Remotely Accessed Direct Pay Permit, the seller should not collect any tax on the transaction. If the customer provides a fully completed Streamlined certificate of exemption, the Taxpayer must collect tax only on a portion of the retail sales price as indicated on the certificate.

#### *Use of Software by the Taxpayer*

In order to provide its Service Offerings, the Taxpayer purchases and uses software, including software that it accesses remotely via the Internet from locations in Tennessee. The seller of such software used by the Taxpayer in Tennessee must generally collect tax from the Taxpayer on the retail sales price of such software. However, if it is not readily apparent to the seller that the Taxpayer is accessing and using the software in Tennessee, or if the Taxpayer provides to the seller a Remotely Accessed Software Direct Pay Permit, the seller is not obligated to collect tax. The Taxpayer must, however, remit tax to the Department on the portion of the sales price allocated to its Tennessee users. Alternatively, if the Taxpayer presents the seller with a fully completed Streamlined certificate of exemption, the Taxpayer must pay, and the seller must collect, tax based on the Taxpayer's percentage of users located inside of Tennessee.

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<sup>33</sup> See TENN. CODE ANN. § 67-6-502.

<sup>34</sup> TENN. CODE ANN. § 67-6-501(c); see TENN. CODE ANN. § 67-6-102(81) (defining "sales price").

The Taxpayer must allocate the sales price based on the number of users located in Tennessee divided by the total number of users represented in the transaction. The Taxpayer must determine the location of its users by looking to the residential street address or primary business address of each user. The Taxpayer should use its best efforts to determine the number and location of users at the time of sale based on the information available to it at the time. If a material change in this number occurs during a purchase of a recurring nature, the Taxpayer must take reasonable steps to adjust the allocation percentage accordingly.

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