

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 16-07**

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

[TAXPAYER] (the "Taxpayer") is a [REDACTED – SERVICE] provider headquartered in [LOCATION]. The Taxpayer's [REDACTED – PRODUCTS] include [REDACTED]. The Taxpayer directly owns and controls one hundred percent of [REDACTED] operating subsidiaries that provide [REDACTED – PRODUCTS] (the "Affiliates").

In providing [REDACTED] services, the Taxpayer utilizes both prewritten and custom software that it purchases from third parties. The Taxpayer maintains a data center located in [STATE – NOT TENNESSEE] where it stores these software applications for use by the Taxpayer's employees, including employees located within Tennessee. The Taxpayer does not license the software to its Affiliates, nor do the Affiliates' employees access the software.

The Taxpayer's Tennessee-based employees access the software remotely from locations within Tennessee through a variety of means, including Web browsers, point-to-point communication services contracted from third parties, and a virtual private network. These employees access the software to process, store, network, manage, and distribute data derived from providing [REDACTED] services to customers.

Additionally, the Taxpayer provides various support services to the Affiliates, including [REDACTED] (the "Support Services"). For these services, the Taxpayer charges the Affiliates a [REDACTED] fee equal to the actual cost the Taxpayer incurs in providing these support services. The Taxpayer's employees access the software remotely from locations within Tennessee to provide the Support Services to the Affiliates.

RULINGS

1. Are the fees that the Taxpayer charges the Affiliates for providing the Support Services subject to Tennessee sales and use tax?

Ruling: No, the fees that the Taxpayer charges for its Support Services are not subject to the Tennessee sales and use tax because these services are not specifically enumerated taxable services under Tennessee law.

2. Are the charges that the Taxpayer incurs when it purchases software from third parties that is installed onto the Taxpayer's server at its [STATE – NOT TENNESSEE] data center and remotely accessed by employees from locations within Tennessee subject to Tennessee sales and use tax?

Ruling: No, the charges that the Taxpayer incurs for software installed at a location outside of Tennessee and remotely accessed by the Taxpayer's employees in Tennessee are not subject to Tennessee sales and use tax.

ANALYSIS

LEGAL BACKGROUND

Under the Retailers' Sales Tax Act,¹ 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."²

¹ 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)).

TENN. CODE ANN. § 67-6-102(78)(C) (Supp. 2015) defines “sale” in pertinent part to include “the furnishing of any of the things or services” taxable under the Retailers’ Sales Tax Act.³ The Tennessee sales and use tax applies to retail sales of services specifically enumerated in the Retailers’ Sales Tax Act.⁴

Additionally, 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.⁵

“Computer software” is “a set of coded instructions designed to cause a computer . . . to perform a task.”⁶ Computer software is “delivered electronically” if delivered “by means other than tangible storage media.”⁷ 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.⁸

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.⁹

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

² TENN. CODE ANN. § 67-6-102(76) (Supp. 2015).

³ TENN. CODE ANN. § 67-6-102(78)(C).

⁴ 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 (2015); *Covington Pike Toyota, Inc. v. Caldwell*, 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) (providing that sales tax does not apply to all services; rather, it only applies to retail sales of services specifically enumerated by statute).

⁵ 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).

⁶ TENN. CODE ANN. § 67-6-102(18).

⁷ TENN. CODE ANN. § 67-6-102(24).

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

⁹ TENN. CODE ANN. § 67-6-102(78)(K).

[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.¹⁰

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 1977,¹¹ 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.¹² 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.¹³ 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 data, digital codes, or computer software; or the service of converting, managing, and distributing digital products.¹⁴

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.

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

¹¹ 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).

¹² 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).

¹³ 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).

¹⁴ 2015 Tenn. Pub. Acts Ch. 514, § 22 (codified at TENN. CODE ANN. § 67-6-231(a)(2) (Supp. 2015)).

APPLICATION

1. Support Services

The fees that the Taxpayer charges the Affiliates for the Support Services are not subject to the Tennessee sales and use tax.

No sale, transfer, or electronic delivery of tangible personal property or computer software occurs in Tennessee when the Taxpayer charges its Affiliates for the provision of Support Services. Although the Taxpayer's employees remotely accesses its software housed at its out-of-state data center to perform the services, the Taxpayer does not transfer title, possession, or control of the software programs at any time, nor do its Affiliate customers electronically download the software programs.

Moreover, the Taxpayer is not furnishing taxable services in Tennessee. As previously stated, only specifically enumerated services and things, such as the use of computer software, are subject to the Tennessee sales and use tax. With respect to the taxable use of computer software that remains in possession of the dealer, TENN. CODE ANN. § 67-6-231(a)(2) requires the access and use of the computer software by a customer from a location in this state. In this instance, it is the Taxpayer's employees that remotely access and use the computer software to perform services.

TENN. CODE ANN. § 67-6-231(a)(2) clarifies that the application of the sales and use tax to remotely accessed software does not make otherwise nontaxable services subject to tax. The fact that the Taxpayer uses computer software to perform the Support Services is irrelevant.

Accordingly, the Taxpayer's services Support Services are not subject to the Tennessee sales and use tax.

2. Software Hosted at the Data Center

The charges that the Taxpayer incurs for software that it purchases and hosts on servers located outside of Tennessee and that is remotely accessed by the Taxpayer's employees from locations within Tennessee are not subject to Tennessee sales and use tax.

Under these circumstances, there is no sale, lease, license, or transfer of the computer software in this state since the software is delivered to an out-of-state location. Although the Taxpayer's employees access or use the software remotely from locations within Tennessee, the sale of the software has already occurred outside of Tennessee. The Taxpayer's subsequent provision of access and use of software to itself, whether used to provide [REDACTED] products to its customers or the Support Services to its Affiliates, is not subject to Tennessee sales and use tax. The access and use of the software is not under the remotely accessed software provisions because the software is not in the possession of the seller.

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APPROVED:

Richard H. Roberts
Commissioner of Revenue

DATE:

September 8, 2016