TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 17-02

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 the transfer of computer software and the provision of computer software repair and other services to an affiliated company.

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

[PARENT COMPANY] (the "Parent Company") is the parent company of the entities in its affiliated group, which includes [REDACTED—CORPORATION] and [TAXPAYER] (the "Taxpayer"). [REDACTED]. [REDACTED—CORPORATION] is a [REDACTED—SERVICE PROVIDER]. The Taxpayer provides back office and information technology services to [REDACTED—CORPORATION] and other [REDACTED] companies in the affiliated group.

An affiliate of the Parent Company acquired [ACQUIRED ENTITY], [REDACTED] has [REDACTED] 100% controlled subsidiaries in its affiliated structure (the "Acquired Entities"). The Acquired Entities developed a significant amount of information technology systems and software (the "Internally Developed Software") prior to the acquisition, which requires extensive integration, development, software modifications, and alignment with the Parent Company's information technology systems used in its affiliated group through coordinated efforts with the Taxpayer's technology and software support group. To facilitate this effort, the Acquired Entities will transfer title to certain of their Internally Developed Software to the Taxpayer as well as render software repair and other services to the Taxpayer.

The Parent Company directly controls 100% of the Taxpayer and [REDACTED—CORPORATION]. The Acquired Entities are under [REDACTED—CORPORATION] in a tiered corporate ownership structure, in which [REDACTED—CORPORATION] has 100% control of the Acquired Entities.

RULINGS

1. Is the transfer of title to the Internally Developed Software from the Acquired Entities to the Taxpayer subject to the Tennessee sales and use tax?

   Ruling: The transfer of title to the Internally Developed Software from the Acquired Entities to the Taxpayer is exempt from the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-395(a) (Supp. 2016).

2. Is the provision of software repair and other services by the Acquired Entities to the Taxpayer subject to the Tennessee sales and use tax?

   Ruling: The Acquired Entities' provision of software repair and other services to the Taxpayer is exempt from the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-395(b).

ANALYSIS

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]

TENN. CODE ANN. § 67-6-102(78)(A) (Supp. 2016) 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-

[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)).

[2] TENN. CODE ANN. § 67-6-102(76) (Supp. 2016).

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."[3]

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.[4] 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]

TENN. CODE ANN. § 67-6-395(a) exempts from the Tennessee sales and use tax an entity's use of computer software internally developed by an affiliate. It provides that "[t]here is exempt from the tax imposed by this chapter the use of computer software that is developed and fabricated by an affiliated company, regardless of whether such software is accessed and used as described in § 67-6-

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[3] 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),

[4] TENN. CODE ANN. § 67-6-102(78)(C).

[5] TENN. CODE ANN. § 67-6-231(a)(1) (Supp. 2016). 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).

231(a)(2) or delivered by other means." Additionally, § 67-6-395(b) provides that "the repair of computer software or any other services otherwise taxable that are rendered by a company for an affiliated company" are exempt from the Tennessee sales and use tax.

Companies are affiliated for purposes of TENN. CODE ANN. § 67-6-395 if either company directly owns or controls 100% of the ownership interest in the other company or both companies are 100% owned or controlled by a common parent.[10] Here, the Taxpayer and the Acquired Entities are affiliated companies for purposes of TENN. CODE ANN. § 67-6-395, as the Parent Company is a common parent that controls 100% of both the Taxpayer and the Acquired Entities.[11]

Because the Taxpayer and the Acquired Entities are affiliated companies for purposes of TENN. CODE ANN. § 67-6-395, the Acquired Entities' transfer of title to the Internally Developed Software and provision of software repair and other services to the Taxpayer are exempt from the Tennessee sales and use tax. Although the Acquired Entities created the Internally Developed Software prior to becoming affiliated with the Taxpayer, TENN. CODE ANN. § 67-6-395(a) does not require that computer software used by an affiliated company be developed or fabricated only after the companies become affiliated. The provision of computer software repair and other services is explicitly exempt from the Tennessee sales and use tax when performed by an affiliated company pursuant to TENN. CODE ANN. § 67-6-395(b).

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APPROVED: David Gerregano
Commissioner of Revenue

DATE: March 26, 2017

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[10] TENN. CODE ANN. § 67-6-395(c).

[11] *See* TENN. CODE ANN. § 67-6-395(c)(2).The Parent Company directly controls 100% of the ownership interest of the Taxpayer and indirectly controls 100% of the ownership interest of the Acquired Entities through its tiered ownership structure.