

TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 17-18

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 Tennessee sales and use tax to pre-recorded online training courses accessed via monthly subscription.

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") has been in business since [YEAR] and is principally engaged in providing access, via subscription, to online [REDACTED] training courses. The Taxpayer developed

the courses through its network of authors comprised of experts in various [REDACTED] disciplines (the “authors”). The Taxpayer’s online [REDACTED] training courses primarily focus in the fields of [REDACTED]. The Taxpayer created a virtual classroom that allows people to learn, teach, and connect. The Taxpayer’s subscribers are able to enhance existing, or obtain new, [REDACTED] skills enabling them to improve their careers and productivity.

To provide a high-quality educational experience to subscribers, the Taxpayer contracts with the authors who create pre-recorded training courses on their topic [REDACTED] of expertise. The courses all come with access to a course-specific discussion board that allows the subscriber to interact with the course instructor and other subscribers. The authors often respond quickly, sometimes within minutes, of receiving a question on the discussion boards. [REDACTED]. Additionally, there is also interaction between subscribers.

The Taxpayer’s subscribers are divided into [REDACTED] groups: [REDACTED]. [REDACTED].

Several of the Taxpayer’s courses help prepare subscribers for active certifications issued by various businesses. Other courses provide continuing education units or professional development units for the subscribers who complete the courses.

Subscribers are granted a temporary license to access the Taxpayer’s complete course library for a monthly or annual fee (the “Subscription”). Subscribers may view an unlimited number of courses during the Subscription period. The Taxpayer retains 100% of the intellectual property rights related to these courses, and subscribers are prohibited from retaining, storing or redistributing any of the training accessed via their Subscriptions.

Subscribers can access the online courses via any device that connects to the Internet via an Internet browser or that can access the appropriate viewing app. During their Subscription period, subscribers can also download content for certain training courses, including exercise files, course slides, and sample code. Subscribers can also download a free viewer that enables them to temporarily download and view training videos offline during the Subscription period. Once the Subscription period ends, the Subscribers’ access to video learning content is terminated and they must renew their Subscription in order to regain access to the educational material.

The Taxpayer offers [REDACTED] Subscription plans: [REDACTED]. The subscribers primarily use the Taxpayer’s service offerings to expand their knowledge with the expert content contained in the course library as well as the ability to communicate with the course authors and other subscribers via an interactive discussion board. However, each Subscription comes with additional features that Taxpayer provides at no additional charge and is included in the Subscription fee. For example:

- [REDACTED – FREE FEATURES]

The [REDACTED] plans contain additional features [REDACTED] than the [REDACTED] plan. The [REDACTED] plan, which is a multi-learner package, comes with all of the features mentioned above as well as: [REDACTED – ADDITIONAL FEATURES].

Finally, the [REDACTED] plan contains, in addition to the [REDACTED] package features: [REDACTED – ADDITIONAL FEATURES].

RULING

Are the Taxpayer's Subscriptions to pre-recorded online [REDACTED] training courses subject to Tennessee sales and use tax?

Ruling: Yes, the Taxpayer's Subscriptions to pre-recorded online [REDACTED] training courses are subject to Tennessee sales and use tax under TENN. CODE ANN. § 67-6-233.

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) 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."³ The sales tax also applies to retail sales of services specifically enumerated in the Retailers' Sales Tax Act.⁴

Additionally, the term "sale" includes "the furnishing of any of the things or services" taxable under the Retailers' Sales Tax Act.⁵ One of the "things" specifically taxable is the "retail sale, lease, licensing or use of specified digital products transferred to or accessed by subscribers or consumers" in

¹ 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)).

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

³ TENN. CODE ANN. § 67-6-102(89)(A). 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."

In 2015, the Tennessee General Assembly adopted into law 2015 Tenn. Pub. Acts Ch. 514, § 22 (effective July 1, 2015). This 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 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."

⁴ For example, the furnishing of "intrastate, interstate or international telecommunication services" is one such specifically enumerated service. "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."

⁵ TENN. CODE ANN. § 67-6-102(78)(C).

Tennessee.⁶ The term “specified digital products” is defined in TENN. CODE ANN. § 67-6-102(86) as “electronically transferred digital audio-visual works, digital audio works and digital books.” Specified digital products include “electronically transferred digital audio-visual works, digital audio works and digital books.”⁷ Digital audio-visual works are “a series of related images that, when shown in succession, impart an impression of motion, together with accompanying sounds, if any, that are transferred electronically” and include “motion pictures” as well as “news and information programs.”⁸ Digital books are “works that are generally recognized in the ordinary and usual sense as ‘books’ that are transferred electronically, including works of fiction and nonfiction and short stories.”⁹

Finally, 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.¹⁰ When a transaction involves taxable and nontaxable components and the transaction’s true object or a “crucial,”¹¹ “essential,”¹² “necessary,”¹³ “consequential,”¹⁴ or “integral”¹⁵ element of the transaction is subject tax, the entire transaction is subject to sales tax.¹⁶ Only if the true object of the transaction is

⁶ TENN. CODE ANN. § 67-6-233(a) (Supp. 2015).

⁷ TENN. CODE ANN. § 67-6-102(86).

⁸ TENN. CODE ANN. § 67-6-102(28).

⁹ TENN. CODE ANN. § 67-6-102(29). The definition of “digital books” excludes “newspapers, magazines, periodicals, chat room discussions [and] weblogs. TENN. CODE ANN. § 67-6-102(29).

¹⁰ 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>.

¹¹ 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).

¹² *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).

¹³ See *supra* note 12.

¹⁴ 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”).

¹⁵ See *AT&T Corp. v. Johnson*, 2002 WL 31247083, at *8.

¹⁶ See generally *Ltr. Rul. No. 14-10*, *supra* note 10.

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.¹⁷

The true object of the Taxpayer’s Subscriptions is access to specified digital products and, as such, is subject to the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-233.

Under TENN. CODE ANN. § 67-6-233(a), the “retail sale, lease, licensing or use of specified digital products transferred to or accessed by subscribers or consumers” in Tennessee¹⁸ is subject to the Tennessee sales and use tax. Taxable retail sales, leases, licensing, or use of specified digital products include: “[s]pecified digital products sold with rights of less than permanent use; [s]pecified digital products sold with rights of use *conditioned upon continued payment by the subscriber or purchaser*; and [s]ubscriptions to, access to or the purchase of a digital code for receiving or accessing specified digital products.”¹⁹

First, the Taxpayer provides the customer with access to specified digital products, which are defined to include “electronically transferred digital audio-visual works, digital audio works and digital books.”²⁰ Here, the subscribers pay a monthly or yearly fee in exchange for continuing access to the Taxpayer’s entire library of pre-recorded courses. These pre-recorded courses are digital audio-visual works, which is a type of specified digital product.

Second, the Subscription constitutes a retail sale, lease, licensing, or use of specified digital products as described in TENN. CODE ANN. § 67-6-233(b)(1)-(3). Here, subscribers pay a yearly fee in exchange for continuing access to the entire pre-recorded course library, which contain numerous specified digital products. This type of transaction is properly described as a “subscription” or a sale “with rights of use conditioned upon continued payment by the subscriber.”²¹

Finally, although other services are included in the Subscriptions, many of which may not be otherwise subject to Tennessee sales and use tax, none of those additional services are essential or crucial elements of the Subscription. Without the subscriber being able to first learn the new or additional skills via watching the pre-recorded online videos, none of the other service offerings would be of any value to the subscriber. The true object, therefore, is access to the course library.

Accordingly, the Taxpayer’s Subscriptions are subject to the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-233 as the sale of access to specified digital products.

¹⁷ See generally *id.*

¹⁸ The tax applies to retail sales in Tennessee, “indicated by the residential street address or the primary business street address of the subscriber or consumer.” TENN. CODE ANN. § 67-6-233(g).

¹⁹ TENN. CODE ANN. § 67-6-233(b)(1)-(3) (emphasis added).

²⁰ TENN. CODE ANN. § 67-6-102(86).

²¹ See TENN. CODE ANN. § 67-6-233(b)(1)-(3). Because the Subscription constitutes a subscription to specified digital products, the fact that the customer accesses the specified digital products at some future point following payment of the annual membership fee is inconsequential to the application of the sales and use tax.

Brent C. Mayo
Assistant General Counsel

APPROVED: David Gerregano
Commissioner of Revenue

DATE: 11/6/17