

TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 19-04

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 database services and an Internet-based information system.

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] that provides [TYPE OF SERVICES] [REDACTED].

1. [MAIN SERVICE] Database

The Taxpayer's main service offering is [REDACTED], a web-based information database [REDACTED]. The Taxpayer maintains the database and makes the information available to customers for a monthly access fee. Customers are assigned a personalized account login that allows them to access the [REDACTED] database and generate customized reports within the Taxpayer's web-based portal.¹

The Taxpayer also provides optional services and products for additional service fees. As discussed below, these additional fees can take the form of a per-item fee, a one-time fee, a monthly fee, or some combination thereof.

2. Auto-Notification Service

The Taxpayer will auto-notify potential buyers of [ITEMS FOR SALE] [REDACTED] for a fee that entitles the customer to [NUMBER] notifications.² To use this service, [TAXPAYER'S CLIENT] sets up the search parameters and an e-mail address for a potential buyer in the [MAIN SERVICE] database, and [MAIN SERVICE] automatically notifies the potential buyer of the new [ITEMS FOR SALE] by e-mail.

3. License for [MAIN SERVICE] Data

The Taxpayer offers a [REDACTED] license to use the [MAIN SERVICE] data for a specifically approved purpose, pursuant to a [REDACTED] Agreement. The [REDACTED] license allows an existing subscriber to the [MAIN SERVICE] database (or the subscriber's licensee) to directly access or download a specific portion of the data contained in the [MAIN SERVICE] database, and to use that data for a limited purpose beyond simply accessing the [MAIN SERVICE] database. Customers may use the covered data for such things as [REDACTED]. The [REDACTED] Agreements do not include the full suite of offerings that accompany the standard [MAIN SERVICE] subscription. The Taxpayer charges a monthly fee for this license.

4. Fees to limit and maintain the accuracy of [MAIN SERVICE] data on the database

To discourage unfair tactics and prevent the unnecessary accumulation of [MAIN SERVICE] data, the Taxpayer charges a fee to subscribers if they [MANIPULATE MAIN SERVICE DATA]. The Taxpayer also issues notices to and imposes fines on customers for unlawful, unethical, and inaccurate [REDACTED] information submitted to the database, in an effort to motivate customers to keep the [MAIN SERVICE] data accurate.

5. [REDACTED] System

[REDACTED].

The Taxpayer charges customers an annual access fee and a fee for [REDACTED]. The annual access fee allows the customer to access the [REDACTED] System for one year and includes [ITEM of

¹ The Taxpayer provides additional services to its customers as part of its monthly access fee. These services include [REDACTED].

² The Taxpayer provides [NUMBER] auto-notifications to a customer as part of its monthly access fee. Customers must pay for the auto-notification service for notifications in excess of [NUMBER].

TANGIBLE PERSONAL PROPERTY] and access to data [REDACTED]. The Taxpayer charges an additional fee for replacement [ITEM of TANGIBLE PERSONAL PROPERTY].

RULING

1. Is the Taxpayer's [MAIN SERVICE] database service subject to Tennessee sales and use tax?

Ruling: No. The Taxpayer's [MAIN SERVICE] database service is not subject to Tennessee sales and use tax. Although the [MAIN SERVICE] database service involves the use of remotely accessed computer software, the primary purpose of the service is the nontaxable data processing and information service.

2. Is the Taxpayer's [REDACTED] service subject to Tennessee sales and use tax?

Ruling: No. The Taxpayer's [REDACTED] service is not subject to Tennessee sales and use tax. Although the [REDACTED] service includes an e-mail messaging component, the primary purpose is providing database information to customers, which is not taxable as a telecommunications service.

3. Is the Taxpayer's license for [MAIN SERVICE] data subject to Tennessee sales and use tax?

Ruling: No. The Taxpayer's license for [MAIN SERVICE] data is not subject to Tennessee sales and use tax. The license provides a customer specified limited access to use certain data contained in the Taxpayer's nontaxable data processing and information service.

4. Are the Taxpayer's fees to limit and maintain the accuracy of the [MAIN SERVICE] data subject to Tennessee sales and use tax?

Ruling: No. The fees to limit and maintain the accuracy of the [MAIN SERVICE] data are not subject to Tennessee sales and use tax because they are charges made in conjunction with having access to a nontaxable data processing and information service.

5. Are the Taxpayer's [REDACTED] fee and annual fee for access to the [REDACTED] System subject to Tennessee sales and use tax?

Ruling: Yes. The Taxpayer's [REDACTED] fee is subject to Tennessee sales and use tax as the sale of tangible personal property for a consideration; the annual fee for access to the [REDACTED] System is subject to Tennessee sales and use tax as part of the sales price of the [ITEM OF TANGIBLE PERSONAL PROPERTY].

ANALYSIS

Under the Retailers' Sales Tax Act, the retail sale in Tennessee of tangible personal property and specifically enumerated services are subject to sales and use tax, unless an exemption applies.³

³ Tennessee Retailers' Sales Tax Act, Ch. 3, §§ 1-18, 1947 Tenn. Pub. Acts Ch. 22, §§ 2254 (codified as amended at TENN. CODE ANN. §§ 67-6-101 to -907 (2018)).

“Retail sale” is defined as “any sale, lease, or rental for any purpose other than for resale, sublease, or subrent.”⁴

TENN. CODE ANN. § 67-6-102(78)(A) (2018) defines “sale,” in pertinent part, to mean “any transfer of title or possession, or both . . . 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.”⁵ 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.”⁶

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 customer 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

In response to advances in technology that allow the remote access and use of software over the Internet, the Tennessee General Assembly adopted into law 2015 Tenn. Pub. Acts Ch. 514, § 22. This law effectively treats all uses of computer software in this state equally, regardless of how a person accesses the software. It amends TENN. CODE ANN. § 67-6-231 to include a new subdivision (b), which states in pertinent part that:

⁴ TENN. CODE ANN. § 67-6-102(76) (2018).

⁵ TENN. CODE ANN. § 67-6-102(89)(A).

⁶ TENN. CODE ANN. § 67-6-102(68) further 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.”

⁷ TENN. CODE ANN. § 67-6-102(78)(C).

⁸ TENN. CODE ANN. § 67-6-231(a) (2018). 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).

⁹ TENN. CODE ANN. § 67-6-102(18).

¹⁰ TENN. CODE ANN. § 67-6-102(24).

[f]or purposes of subsection (a), “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.¹¹

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 1977,¹² remains subject to sales and use tax regardless of a customer’s chosen method of use.

The Tennessee sales tax also applies to retail sales of services specifically enumerated in the Retailers’ Sales Tax Act.¹³ In particular, TENN. CODE ANN. § 67-6-205(c)(3) (2018) imposes the sales tax on retail sales of the service of “furnishing, for a consideration, of intrastate, interstate or international telecommunication services.” “Telecommunications service” is defined 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.”¹⁴ However, “telecommunication service” does not include data processing and information services or Internet access services.¹⁵

Furthermore, 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. As reassurance of this fact, the General Assembly included language in Section 22 stating that nothing in the new subdivision (b) 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.¹⁶

¹¹ 2015 Tenn. Pub. Acts Ch. 514, § 22 (codified at TENN. CODE ANN. § 67-6-231(b) (2018)).

¹² 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 405, 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).

¹³ *See* TENN. CODE ANN. § 67-6-205(c) (2018).

¹⁴ TENN. CODE ANN. § 67-6-102(90)(A).

¹⁵ TENN. CODE ANN. § 67-6-102(90)(B).

¹⁶ 2015 Tenn. Pub. Acts Ch. 514, § 22 (codified at TENN. CODE ANN. § 67-6-231(b) (2018)).

Therefore, while TENN. CODE ANN. § 67-6-231(b) (2018) 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.¹⁷ When a transaction involves taxable and nontaxable components and the transaction's true object or a "crucial,"¹⁸ "essential,"¹⁹ "necessary,"²⁰ "consequential,"²¹ or "integral"²² element of the transaction is subject to tax, the entire transaction is subject to sales tax.²³ 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.²⁴

1. [MAIN SERVICE] Database

The Taxpayer's main service offering is the [MAIN SERVICE] database. The Taxpayer compiles [DATA], stores the data on its own servers, and allows customers to access the data through the Taxpayer's web-based portal using their own internet service. The primary purpose of the Taxpayer's [MAIN SERVICE] database service is providing [REDACTED] data to customers. Pursuant to TENN. CODE ANN. § 67-6-102(90)(B)(i), such data processing and information services are not considered taxable telecommunication services when the "purchaser's primary purpose for the underlying transaction is the processed data or information." Thus, the [MAIN SERVICE] database service is not taxable as a telecommunications service.

With respect to the taxable use of computer software in this state that remains in possession of the dealer, TENN. CODE ANN. § 67-6-231(b) requires the access and use of the computer software by a

¹⁷ 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).

¹⁸ 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).

¹⁹ *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 product 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).

²⁰ See *supra* note 20.

²¹ 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").

²² See *AT&T Corp. v. Johnson*, 2002 WL 31247083, at *8.

²³ See generally Ltr. Rul. No. 14-10, *supra* note 19.

²⁴ See generally *id.*

customer from a location within Tennessee. However, TENN. CODE ANN. § 67-6-231(b) clarifies that the application of the sales and use tax to remotely accessed software does not make otherwise nontaxable services subject to tax. TENN. CODE ANN. § 67-6-231(b) specifically states that “information or data processing services” and “the storage of data” remain nontaxable for Tennessee sales and use tax purposes.²⁵ Although the Taxpayer’s web-based portal constitutes computer software for Tennessee sales and use tax purposes,²⁶ and the Taxpayer’s customers access the portal from locations within Tennessee, a customer’s use of the portal is merely incidental to the true object of the [MAIN SERVICE] information database service. Customers do not purchase access to the Taxpayer’s [MAIN SERVICE] database to access the web-based portal; rather, customers purchase access for the [REDACTED] information services. The web-based portal is merely a tool to view the end result of the information services that customers purchase from the Taxpayer.

Because the Taxpayer does not sell the [MAIN SERVICE] software to its customers, nor does it provide a taxable service by providing access to the [MAIN SERVICE] information database service, the charges for use of the [MAIN SERVICE] database service are not subject to Tennessee sales and use tax.

2. Auto-Notification Service

The Taxpayer’s auto-notification service automatically notifies [CUSTOMERS] of new [MAIN SERVICE] database listings via e-mail, based on their chosen [REDACTED] search parameters. The service necessarily employs telecommunications. However, “the fact that a service might employ, involve, or be accessed by telecommunications, without more, will not transform it into a taxable telecommunications service.”²⁷ Although the Taxpayer’s auto-notification service sends electronic communications to [CUSTOMERS], the customer’s primary purpose in purchasing this service is the processed [MAIN SERVICE] data itself. As such, pursuant to TENN. CODE ANN. § 67-6-102(90)(B)(i), the Taxpayer’s auto-notification service is not a taxable telecommunications service.

Therefore, the Taxpayer’s auto-notification service is not subject to Tennessee sales and use tax.

3. License for [MAIN SERVICE] Data

As noted above, the Taxpayer’s charges for use of the [MAIN SERVICE] database service are not subject to Tennessee sales and use tax because the Taxpayer does not sell the [MAIN SERVICE] software to its customers, nor does it provide a taxable service by providing access to the [MAIN SERVICE] information database service. Similarly, the Taxpayer’s worldwide license to use its [MAIN SERVICE] data for specific, approved purposes, as set out in Third Party Data Access Agreements, is also a nontaxable service because the customer’s primary purpose in entering into the Third Party Data Access Agreement is to obtain access to a specific portion the information contained in the [MAIN SERVICE] database.

²⁵ TENN. CODE ANN. § 67-6-231(b).

²⁶ See TENN. CODE ANN. § 67-6-102(18).

²⁷ *Qualcomm Inc. v. Chumley*, No. M2006-01398-COA-R3-CV, 2007 WL 2827513, at *8 (Tenn. Ct. App. Sept. 26, 2007).

Thus, license fees to use the Taxpayer's [MAIN SERVICE] data are not subject to Tennessee sales and use tax.

4. Fees to limit and maintain the accuracy of [MAIN SERVICE] data on the database

The Taxpayer's imposition of fees and fines to discourage customers from cluttering or improperly manipulating the [MAIN SERVICE] data are charges made in conjunction with having access to a nontaxable data processing and information service. In order to be subject to such fees or fines, a customer must first pay for access to the [MAIN SERVICE] database. The customer is only charged a fee or fine for a violation of that access.

Because the charges for use of the [MAIN SERVICE] database service are not subject to Tennessee sales and use tax, any fees and fines paid in conjunction with access to the [MAIN SERVICE] database are also not subject to Tennessee sales and use tax.

5. [REDACTED] System

Tennessee imposes a sales tax on the "sales price of each item or article of tangible personal property when sold at retail in this state."²⁸ The "sales price" upon which tax is due is the "total amount of consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction" for charges by the seller for any services necessary to complete the sale.²⁹

Sales of the Taxpayer's [REDACTED] System involve multiple components: [REDACTED – ITEMS OF TANGIBLE PERSONAL PROPERTY], and an annual access fee. Because the sale of the [REDACTED] System involves both tangible personal property and services, and the tangible components are necessary to complete the sale, all the fees associated with these components make up the sales price of the system. Accordingly, the Taxpayer's [REDACTED] fee is subject to Tennessee sales and use tax as the sale of tangible personal property for a consideration and the annual fee for access to the [REDACTED] System is subject to Tennessee sales and use tax as part of the sales price of the [ITEMS OF TANGIBLE PERSONAL PROPERTY].

APPROVED: David Gerregano
Commissioner of Revenue

DATE: 7/26/19

²⁸ TENN. CODE ANN. § 67-6-202(a) (2018).

²⁹ TENN. CODE ANN. § 67-6-102(79)(A). *See also* TENN. COMP. R. & REGS. 1320-05-01-.32(1) (1987).