

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 20-04**

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 instructor-led online courses and self-study online courses.

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 [STATE OTHER THAN TENNESSEE] corporation based in [CITY, STATE]. The Taxpayer has no physical locations in Tennessee. The Taxpayer prepares students for new careers by offering online courses in [REDACTED]. All the Taxpayer's programs are non-degree and unaccredited.

The Taxpayer's courses may include live instructors. All courses include one-on-one online mentoring from subject matter experts, and guided assessments to help students acquire the knowledge and skills needed to obtain a job in a [REDACTED]-related field. Mentors help students understand concepts, review students' work and provide feedback, and build individual relationships with their assigned students. Mentors use those relationships to hold their students accountable to their goals and give them exposure to industry practices.

The following methods of instruction apply to all the Taxpayer's programs:

- Students read curriculum available at [TAXPAYER'S WEBSITE]. Each program has several phases, and each phase concludes with a mastery evaluation in the form of a [FINAL PROJECT] and a mock interview. Students may be required to complete an exercise from another website that is not on [TAXPAYER'S WEBSITE].
- Students complete lessons and graded projects.
- Students may exchange electronic correspondence with their mentor using either [A THIRD-PARTY WEBSITE],¹ or by email.
- Students meet with their mentor via video chat [NUMBER OF TIMES] a week for [PERIOD OF TIME] to [REDACTED], discuss the curriculum, and/or ask questions about projects in progress.
- Students receive feedback on their progress via electronic correspondence and sessions with their mentor.
- Students meet one-on-one with their academic [COUNSELOR] online at least [NUMBER OF TIMES] a month. The academic [COUNSELOR'S] goal is to keep students on track in completing their courses.
- Students can engage with other students and mentors on [A THIRD-PARTY WEBSITE] via an invite to [THIRD-PARTY WEBSITE].
- Students can join [REDACTED] video call to request help from an available mentor and discuss curriculum, ask questions, or get career support.
- Students can join online live workshops. They are not required but available to all course format students. They are primarily used by students enrolled in a [FORMAT 3] course. Students enrolled in an [FORMAT 1] course have separate workshops.
- Students in all programs are also required to attend a minimum number of [REDACTED] meetups through www.meetup.com,² an on-line community the students can use to find events in their local area that will provide them with networking opportunities.

The Taxpayer offers three course formats: [FORMAT 1, FORMAT 2, AND FORMAT 3]. Students taking the [FORMAT 1] course are expected to dedicate at least [NUMBER] active hours to the program through structured online classes taking place [REDACTED], and must complete [NUMBER] total course hours. Students meeting the graduation requirements earn a [REDACTED].

Students taking the [FORMAT 2] course are expected to dedicate at least [NUMBER] hours over a [PERIOD OF TIME]. The students in this course type are required to complete [NUMBER] total course hours. Students meeting the graduation requirements earn a [REDACTED].

¹ [REDACTED].

² According to its website, "Meetup is a platform for finding and building local communities. People use Meetup to meet new people, learn new things, find support, get out of their comfort zones, and pursue their passions, together."

All [FORMAT 1] classes and [FORMAT 2] classes are held by a live online instructor who walks through a presentation in each session and takes both written and verbal student questions. Students and the instructor are on video chat for the entire session.

The [FORMAT 3] courses are self-paced and are designed to be completed in a [AMOUNT OF TIME] period. The total number of course hours for this course type depends on the program of study but is typically [NUMBER] hours. There is no penalty in graduating from a [FORMAT 3] course if a student takes longer to complete the course, but students who exceed the [AMOUNT OF TIME] period are charged additional tuition [REDACTED].

There is no live online instruction in the required portion of the [FORMAT 3] courses. Students are, however, required to attend [NUMBER] live weekly one-on-one sessions with a mentor, who is a subject-matter expert in the course subject, to review their work and help them with concepts they are having trouble with.

[FORMAT 3] students are given access to course modules through their online accounts. The modules consist of written material. Students are required to complete all sections of each module and pass assessments that are graded by an instructor. Students must also complete a large project for each course that is turned in and graded by an instructor. The [FORMAT 3] courses also include optional pre-recorded video content that introduces students to specific concepts. Most students choose to access the optional video content.

For all three course formats, students receive a pass or fail grade with written feedback and either graduate or do not graduate. All courses have stated objectives and written lesson plans.

To take any of the Taxpayer's online courses, a prospective student must create an account on the Taxpayer's server, apply for their chosen course and, once approved, pay between [AMOUNT] and [AMOUNT] in tuition, depending on the course of study. All course content and all personal interaction with instructors and mentors occurs online for all three course formats. Students do not download software or course content to their personal computers. Students who are enrolled for at least [NUMBER] months retain access to their course materials even after their enrollment ends.

RULINGS

1. Are the Taxpayer's [FORMAT 1] courses, and [FORMAT 2] courses subject to the Tennessee sales and use tax?

Ruling: No, the Taxpayer's [FORMAT 1] courses, and [FORMAT 2] courses are live, instructor-led courses and are not subject to Tennessee sales and use tax because the student is paying to participate in a live class.

2. Are the Taxpayer's [FORMAT 3] Courses subject to the Tennessee sales and use tax?

Ruling: Yes, the Taxpayer's [FORMAT 3] courses are subject to Tennessee sales and use tax because the student is paying for the use of computer software.

ANALYSIS

Under the Retailer's Sales Tax Act,³ retail sales in Tennessee of tangible personal property and specifically enumerated services are 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."⁴

TENN. CODE ANN. § 67-6-102(78)(A) (Supp. 2019) 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."⁵

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.⁶ 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 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.⁷

³ Tennessee Retailers' Sales Tax Act (codified at TENN. CODE ANN. §§ 67-6-101 to -907 (2018 & Supp. 2019)).

⁴ TENN. CODE ANN. § 67-6-102(76) (Supp. 2019).

⁵ "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).

⁶ TENN. CODE ANN. § 67-6-102(78)(C).

⁷ 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).

“Computer software” is “a set of coded instructions designed to cause a computer . . . to perform a task.”⁸ Computer software is “delivered electronically” if delivered “by means other than tangible storage media.”⁹

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 amended TENN. CODE ANN. § 67-6-231 to include a new subdivision (b), which states in pertinent part that:

[f]or purposes of subdivision (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.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.

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.¹² When a transaction involves taxable and nontaxable components and the transaction’s true object or a “crucial,”¹³ “essential,”¹⁴ “necessary,”¹⁵ “consequential,”¹⁶ or “integral”¹⁷ element of the transaction is

⁸ TENN. CODE ANN. § 67-6-102(18).

⁹ TENN. CODE ANN. § 67-6-102(24).

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

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 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).

¹² See generally Tenn. Dept. of Rev. Ltr. Rul. 14-10 (Oct. 14, 2014) (discussing Tennessee law regarding bundling and the “true object” test), available at <https://www.tn.gov/content/dam/tn/revenue/documents/rulings/sales/14-10.pdf> (last visited March 17, 2020).

¹³ 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).

¹⁴ *Id.*; see also *AT&T Corp. v. Johnson*, No. M2000-01407-COA-R3-CV, 2002 WL 31247083 (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).

subject to tax, the entire transaction is subject to sales tax.¹⁸ Only if the true object of the transaction is not independently subject to sales tax and the items 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.¹⁹

[FORMAT 1] Courses, and [FORMAT 2] Courses

The [FORMAT 1] courses and the [FORMAT 2] courses are not subject to Tennessee sales and use tax because the student is purchasing access to live classes, and the software platform is merely incidental to the transaction. The live instructor-led classes provide the student with access to live lectures via computer.

The use of computer software in this state that remains in possession of the dealer is subject to tax if the access and use of the computer software is by a customer within this state.²⁰ Here, as part of its [FORMAT 1] courses and [FORMAT 2] courses, the Taxpayer provides its students with web-based access to its platform and/or to software in the possession of a third party on its behalf where the students have access to course materials, participate in live classes, interact with mentors and others, and participate in online meetups. Both the Taxpayer’s platform and those of third parties providing access on the Taxpayer’s behalf constitute computer software for Tennessee sales and use tax purposes, and the platforms are accessed by the Taxpayer’s students from locations in Tennessee. A student’s use of the platform software, however, is merely incidental to participating in the live class.

The primary purpose of the platform software is to provide access to a real time presentation where the student can interact with the instructor and view presentation materials. After gaining access, the student is not interacting with a computer program. Instead, the student interacts with the instructor and other students. The platform only facilitates course instruction between the students and instructor, and it is merely incidental to the instructor-led classes.

Consequently, the student is not purchasing the use of the software, but is, instead, purchasing access to live instructor-led classes. With respect to the sales of services in Tennessee, only specifically enumerated services are subject to tax under the Retailers’ Sales Tax Act. The Taxpayer’s live instructor-led classes are not specifically enumerated as taxable under TENN. CODE ANN. § 67-6-205 (Supp. 2019). Accordingly, the Taxpayer’s [FORMAT 1] courses, and the [FORMAT 2] courses are not subject to the Tennessee sales and use tax.²¹

¹⁵ See *Thomas Nelson, Inc. v. Olsen*, 723 S.W.2d 621.

¹⁶ 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”).

¹⁷ See *AT&T Corp. v. Johnson*, 2002 WL 31247083, at *8.

¹⁸ See generally Ltr. Rul. No. 14-10, *supra* note 12.

¹⁹ See generally *id.*

²⁰ TENN. CODE ANN. § 67-6-231(b).

[FORMAT 3] Courses

The [FORMAT 3] courses are remotely accessed software and are subject to Tennessee sales and use tax under TENN. CODE ANN. § 67-6-231(a). The [FORMAT 3] courses provide students with the ability to study and learn course material by accessing computer software via the internet. As explained above, the access and use of dealer-owned computer software by a customer in this state is subject to tax.²²

Here, as part of its [FORMAT 3] courses, the Taxpayer provides students with access to course modules through the students' online accounts. Unlike the [FORMAT 1] courses and the [FORMAT 2] courses, the [FORMAT 3] course modules do not include live, instructor-led classes. Rather, in the [FORMAT 3] courses students primarily learn the course information by reading online text and by answering test questions.

Although other services are included in the [FORMAT 3] courses, some of which may not be otherwise subject to Tennessee sales and use tax,²³ none of those additional services are essential or crucial elements of the [FORMAT 3] courses. Without the student being able to first learn new or additional skills by studying and learning the course material through interacting with the online course modules, none of the other service offerings would be of any value to the student. Unlike the [FORMAT 1] courses and the [FORMAT 2] courses where the true object is access to live instructor-led classes, the true object of the [FORMAT 3] courses is access to the online course modules. Therefore, the [FORMAT 3] courses are subject to Tennessee sales tax when sold to a Tennessee customer because they are remotely accessed software.²⁴

APPROVED: David Gerregano
Commissioner of Revenue

DATE: 6/10/2020

²¹ See, e.g., Tenn. Dept. of Rev. Rev. Rul. 17-17 (Oct. 31, 2017) (holding that on-line training courses are subject to tax).

²² TENN. CODE ANN. § 67-6-231(b).

²³ Note that providing students access to optional pre-recorded video content could constitute the retail sale, lease, licensing, or use of specified digital products as described in TENN. CODE ANN. § 67-6-233(b)(1)-(3) (2018).

²⁴ See e.g., Ltr. Rul. No. 17-17, *supra* note 21.