

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #21-04**

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 Tennessee sales and use tax to a monthly subscription package containing both taxable and non-taxable products and services.

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 technology company headquartered in [STATE] that develops and sells consumer electronics, computer software, online services, and related support. The Taxpayer also sells a range of third-party digital content and applications. The Taxpayer sells its products and services either at its brick and mortar retail locations or online through various company websites and [REDACTED]. The Taxpayer currently offers [NUMBER] kinds of products and services on a stand-alone

basis. Customers may purchase certain products for one lump-sum payment or through a monthly installment plan. Customers may purchase services through a monthly subscription.

CURRENT STAND-ALONE OFFERINGS

1. Devices

The Taxpayer's devices include [REDACTED], and a host of accessories. Customers currently purchase devices for a lump sum payment or on a monthly installment plan.

2. [SUBSCRIPTION MUSIC]

[SUBSCRIPTION MUSIC] is an ad-free music streaming service that allows users to select music to stream to their devices on demand or they can listen to existing, curated playlists. Customers receive a temporary download of the audio/video file as part of this service. Customers subscribe to [SUBSCRIPTION MUSIC] for a monthly fee.

3. [SUBSCRIPTION TV]

[SUBSCRIPTION TV] is a suite of TV and video content available for consumers on a subscription basis. The Taxpayer offers original content and third-party content available to stream on demand. Linear programming and live streaming are limited with this service. Customers pay a monthly subscription fee for access to [SUBSCRIPTION TV].

4. Online Magazines and Newspapers [REDACTED]

The Taxpayer sells a digital newspaper and magazine subscription service, [REDACTED], which gives users unlimited access to over [NUMBER] magazine titles, and approximately [NUMBER] newspapers. Customers pay a monthly subscription fee for access to [ONLINE MAGAZINES AND NEWSPAPERS].

5. Games

The Taxpayer sells a wide variety of online games through its digital distribution platform, [REDACTED], which allows customers to discover and download applications and games and purchase in-application content. Customers may buy individual games/content to download. The Taxpayer also offers a video game subscription service, [REDACTED], that allows subscribers all-you-can-play access to over [NUMBER] games for one monthly price. [VIDEO GAME SUBSCRIPTION SERVICE] allows subscribers to download games to their [REDACTED] devices, but a subscription is required to play a game. If the subscription is canceled, the game can no longer be played unless the subscription is renewed.

6. [CLOUD STORAGE]

[CLOUD STORAGE] is the Taxpayer's cloud service that stores [USER CONTENT], keeping them up to date and available across multiple [REDACTED] devices, [REDACTED]. Customers subscribe to [CLOUD STORAGE] for a monthly fee based the amount of additional storage needed.

7. [WARRANTY CONTRACTS]

The Taxpayer offers a range of warranty, support, and insurance options for its customers. Most of the Taxpayer's hardware comes with a [TIME PERIOD] limited warranty and [TIME PERIOD] of tech support at no additional cost. This service is called [REDACTED]. [REDACTED] extends that coverage up to [TIME PERIOD] and provides additional features such as [TIME PERIOD] tech support and accidental damage coverage. [WARRANTY CONTRACT] may be purchased with the device or separately, as long as the separate purchase is made within [TIME PERIOD] of the device purchase.

8. [INSURANCE]

[REDACTED] offers an insurance product that gives customers the option of paying to have a replacement option (after paying a deductible) if their [DEVICE] is lost or stolen. Customers may purchase a [TIME PERIOD] plan by paying a lump sum amount, or they may enter into a monthly payment plan that covers a [TIME PERIOD]. [INSURANCE] may be purchased with [A DEVICE] or separately, as long as the separate purchase is made within [TIME PERIOD] of the [DEVICE] purchase.

NEW SUBSCRIPTION PACKAGE OFFERINGS

The Taxpayer plans to offer consumers a new way to purchase existing products, services, and support that the Taxpayer traditionally has offered on a stand-alone basis. Specifically, the Taxpayer intends to offer packages for a set monthly subscription price that include specific products and/or services.¹ Although the Taxpayer's packages contain distinct and identifiable products that can be sold separately, all packages will be offered for one non-itemized monthly price. In many instances, the price for the subscription packages will include a discount as an incentive for customers to bundle their purchases. If a package includes a device, the device will be sold through a monthly installment plan or will be available for lease or rental on a month to month basis.

RULINGS

1. When the Taxpayer charges one non-itemized price for a package that includes a taxable item, does the Tennessee sales tax apply to the full price of the package?

Ruling: Yes. Tennessee sales tax applies to the sale of the entire package when the package contains at least one taxable item and is sold for one-non-itemized price.

2. What is the impact if the Taxpayer includes the sale of a device on an installment plan as part of the package?

Ruling: When the Taxpayer sells a device on an installment plan, the Taxpayer is required to report the total selling price of the device upfront for Tennessee sales tax purposes. Sales tax should be applied to remaining taxable products in the package consistent with this ruling.

3. What is the impact if the Taxpayer leases or rents a device as part of the package?

¹ [REDACTED].

Ruling: When the Taxpayer leases or rents a device as part of the package, sales tax is computed based on the terms of the contract, either on the lump sum at the time of execution, or on a monthly or periodical basis.

4. Where items in the Taxpayer's packages are subject to different local sales tax rates, what local sales tax rate applies to the entire package?

Ruling: Product-based tax rates and exemptions are exceptions to the application of the general state and local sales tax rates. When the Taxpayer sells packages that include multiple items and one of the items is taxable at the general rate, the entire package is taxable at the general rate.

ANALYSIS

Under the Retailers' Sales Tax Act, the retail sale in Tennessee of tangible personal property and specifically enumerated services is subject to the sales tax, unless an exemption applies.² A "sale" is defined to include "the furnishing of any of the things or services" taxable under the Retailers' Sales Tax Act.³ Two of the "things" specifically taxable are the "retail sale, lease, licensing or use of specified digital products" and "video game digital products" that are transferred to or accessed by subscribers or consumers in Tennessee.⁴ Specified digital products include digital books, music, and videos as defined in the statute.⁵ "Video game digital product" is also defined, but unlike the other specified digital products, is expressly categorized as computer software.⁶

Tennessee's sales tax is imposed at the general state rate of 7% and the local rate of between 1.5% and 2.75%.⁷ Specified digital products, however, are subject to the state rate of 7% plus a uniform local rate of 2.5%.⁸ Data storage⁹ and digital periodicals¹⁰ are not subject to tax.

Many transactions involve more than the sale of a single item or service. When a transaction involves items or services that are all independently subject to sales tax, the entire transaction is subject to

² TENN. CODE ANN. § 67-6-201; *see also*, TENN. CODE ANN. § 67-6-102(74), (82), and (95)(A)(defining "[r]etail sale" as "any sale, lease, or rental for any purpose other than for resale, sublease, or subrent" and "[t]angible personal property" as including "prewritten computer software").

³ TENN. CODE ANN. § 67-6-102(84)(C).

⁴ TENN. CODE ANN. § 67-6-233(a) (2018).

⁵ TENN. CODE ANN. § 67-6-102(30) (defining "digital audio works," "digital audio-visual works," and "digital books"). The definition of "digital audio-visual works" excludes "video greeting cards sent by electronic mail or video or electronic games."

⁶ TENN. CODE ANN. § 67-6-102(102).

⁷ TENN. CODE ANN. § 67-6-202(a) (Supp. 2020) and TENN. CODE ANN. § 67-6-205(a) (Supp. 2020).

⁸ TENN. CODE ANN. § 67-6-702(g)(4) (Supp. 2020).

⁹ TENN. CODE ANN. § 67-6-231(b) (2018).

¹⁰ TENN. CODE ANN. § 67-6-102(31). The definition of "digital books" excludes "newspapers, magazines, periodicals, chat room discussions [and] weblogs" and Tennessee has not separately imposed a tax on digital newspaper and magazine subscriptions.

sales tax. Similarly, if all the items or services are independently either not subject to sales tax or are exempt, the entire transaction is not subject to sales tax. Here, the Taxpayer is proposing to combine products that are subject to different tax rates and different tax treatment and offer them for a single price.

The question then is whether, based on the products included, the package is taxable. And, if it is, what is the correct tax rate to apply? In Tennessee, 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 the sales tax. This treatment as applied to tangible and digital personal property is set forth in the definition of “sales price,” which states that the sales price includes “[t]he value of exempt personal property given to the purchaser where taxable and exempt personal property have been bundled together and sold by the seller as a single product or piece of merchandise.”¹¹ Based on guidance from Tennessee case law related to the taxation of separate and distinct services,¹² the Department historically has applied this treatment to transactions involving services as well as those involving only tangible or digital personal property.¹³

TAXABILITY OF PACKAGES

The Taxpayer’s packages include varied products that are subject to different tax treatment when sold individually. The Taxpayer’s devices are taxable tangible personal property.¹⁴ [SUBSCRIPTION MUSIC] is a taxable specified digital product because it is a sale of electronically transferred digital audio works.¹⁵ [SUBSCRIPTION TV] is also a taxable specified digital product because it is a sale of electronically transferred digital audio-visual works.¹⁶ The Taxpayer’s online sales of games and gaming subscriptions are subject to sales and use tax because they involve the sale or use of video game digital products.¹⁷ The Taxpayer’s warranty offerings [REDACTED] are taxable warranty or service contracts.¹⁸ [REDACTED] is a non-taxable digital magazine and newspaper service.¹⁹ And the Taxpayer’s cloud service, [REDACTED], is a non-taxable data storage.²⁰

¹¹ TENN. CODE ANN. § 67-6-102(85)(A)(vi).

¹² See generally *Tomkats Catering, Inc. v. Johnson*, 2001 WL 1090516, at *2.

¹³ See Tenn. Dept. of Rev. Ltr. Rul. 14-10 (Oct. 14, 2014), available at <https://www.tn.gov/content/dam/tn/revenue/documents/rulings/sales/14-10.pdf> (last visited April 15, 2021).

¹⁴ TENN. CODE ANN. § 67-6-102(95)(A).

¹⁵ TENN. CODE ANN. § 67-6-102(29).

¹⁶ TENN. CODE ANN. § 67-6-102(30).

¹⁷ TENN. CODE ANN. § 67-6-102(102).

¹⁸ “The retail sale of, use of, or subscription to a warranty or service contract covering the repair or maintenance of tangible personal property” is subject sales tax. TENN. CODE ANN. § 67-6-208(a) (2018).

¹⁹ TENN. CODE ANN. § 67-6-102(31). The definition of “digital books” excludes “newspapers, magazines, periodicals, chat room discussions [and] weblogs” and Tennessee has not separately imposed a tax on digital newspaper and magazine subscriptions.

²⁰ TENN. CODE ANN. § 67-6-231(b).

Packages Without a Device

The Taxpayer's packages may consist of a combination of taxable specified digital products, taxable video game digital products, taxable warranty contracts,²¹ non-taxable digital newspapers and magazines, and/or non-taxable cloud services. TENN. CODE ANN. § 67-6-102(85)(A) provides that the sales price of a good or service equals the "total amount of consideration . . . for which personal property or services are sold." Thus, when the Taxpayer bundles taxable items with nontaxable items and they are sold for a single charge, the entire charge is subject to taxation.²²

Packages Including a Device

A package may include the sale of a device on an installment plan. The definition of "sale" includes "a transfer of possession or control of property under a security agreement or deferred payment plan that requires the transfer of title upon completion of the required payments."²³ When the Taxpayer sells a device on an installment plan, the Taxpayer is required to report the total selling price and pay the applicable sales or use tax due on the entire selling price in the monthly tax period in which the parties enter into the contract.²⁴ Thus, the Taxpayer should report tax on the full price sale of the device when calculating the amount of tax due on a package including the sale of a device on an installment plan.

Instead of including the sale of a device, a package may include the lease or rental of a device.²⁵ When the package includes the lease or rental of a device, the terms of the contract provide the basis for computing the tax.²⁶ "The tax is to be computed on a billing basis, either on the lump sum at the time of execution, or on a monthly or periodical basis as provided in the contract."²⁷

APPLICABLE TAX RATE

TENN. CODE ANN. § 67-6-202(a) (Supp. 2020) imposes tax at a state tax rate of 7% on sales of tangible personal property sold at retail in Tennessee. TENN. CODE ANN. § 67-6-205(a) (Supp. 2020) imposes the same rate of tax on the sales of all taxable services in the state. TENN. CODE ANN. §§ 67-6-233(a) and 67-6-208(a) impose the same rate of tax on sales of specified digital products, video game digital products and warranty contracts. Additionally, cities and counties are authorized to impose a local option sales

²¹ TENN. CODE ANN. § 67-6-208(a) and § 67-6-233(a).

²² See, e.g., *Tomkats Catering, Inc. v. Johnson*, 2001 WL 1090516, at *2; Tenn. Dept. of Rev. Ltr. Rul. 14-10 (Oct. 14, 2014), *supra* note 13.

²³ TENN. CODE ANN. § 67-6-102(84)(l).

²⁴ TENN. COMP. R. & REGS. 1320-05-01-.28.

²⁵ "Lease or rental" means any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration." TENN. CODE ANN. § 67-6-102(51).

²⁶ TENN. COMP. R. & REGS. 1320-05-01-.32(2).

²⁷ *Id.*

tax not to exceed 2.75% on sales and use of the same privileges subject to tax under this chapter.²⁸ However, Tennessee also imposes a special local sales tax of 2.5% on sales of specified digital products that applies in lieu of the regular local option sales tax imposed by the city or county.²⁹ The special rate for specified digital products only applies to those products.

Where the Taxpayer bundles specified digital products with other products taxed at the general rate, the general rate applies to the entire transaction. Similarly, if the Taxpayer includes both taxable and exempt items in a package the exempt items become subject to sales tax. In both cases the general rate will supersede the special rate because the specified digital product local tax rate can only be applied to those specifically listed products but not to bundles that include other taxable products. Consequently, the special rate for specified digital products will apply to the bundle if it includes only specified digital products or only specified digital products and non-taxable products (i.e., [REDACTED]).

SOURCING

In general, for state and local sales tax purposes, sales of tangible personal property and taxable services are sourced according to the following guidelines:

- If a sale is made from a location in Tennessee, the sale is sourced to the business location making the sale.³⁰
- If a sale is made from out-of-state, the seller is required to collect local tax based on the ship to address or delivery destination.³¹

Specified digital products transferred to or accessed by subscribers or consumers are sourced to Tennessee as follows:

- Purchaser/subscriber receives the electronically transferred digital product or digital code at a Tennessee residential or primary business street address in Tennessee, or
- Seller's business records or the address obtained from the purchaser during the sale indicates a Tennessee billing address.³²

Sales of warranty or service contracts covering tangible personal property or computer software are sourced to Tennessee as follows:

²⁸ TENN. CODE ANN. § 67-6-702.

²⁹ TENN. CODE ANN. § 67-6-702(g)(4).

³⁰ TENN. CODE ANN. § 67-6-501; TENN. COMP. R. & REGS. 1320-05-01-.74(1). TENN. COMP. R. & REGS. 1320-05-02-.05(1).

³¹ TENN. CODE ANN. § 67-6-233(g); TENN. CODE ANN. § 67-6-504(m) (Supp. 2020). *See also*, Sales and Use Tax Notice #19-05 Local Sales Tax Reporting by Out-of-State Dealers.

³² TENN. CODE ANN. Sec. 67-6-233(g).

- Warranty or service contracts sold as part of the sale of tangible personal property or software are sourced the same as tangible personal property or computer software.
- If the extended care plan is purchased separate from the [DEVICE], sourcing is based on the location of the covered device and if such location is not known, sourced to the purchaser's residential or primary business address.³³

Conclusion

Consistent with the authority above, if the Taxpayer's package is purchased from a business location in Tennessee, then the sale is sourced to that location and the local sales tax rate that applies is the local rate for the business location. If the sale is made from out-of-state, then tax applies as follows:

- (1) If the package includes tangible personal property that is shipped or delivered to the purchaser or the purchaser's donee in Tennessee, the sale should be sourced to Tennessee. The local sales tax applies to the sale of the package at the rate for the location where the tangible personal property is shipped or delivered. Any warranty contract, specified digital product, and/or video game digital product included in the package is considered to be sourced consistent with the residential or primary business address of the purchaser.
- (2) If the package does not include tangible personal property, but includes a specified digital product, a video game digital product, and/or a warranty contract covering tangible personal property, the sale of the package should be sourced to the Tennessee purchaser's/subscriber's residential or primary business address. The general local sale tax rate will apply unless the package includes only specified digital products or specified digital products and non-taxable products.

APPROVED: David Gerregano
Commissioner of Revenue

DATE: 4/28/2021

³³ TENN. CODE ANN. § 67-6-208(c)(3). *See also*, Sales and Use Tax Notice #15-11 Sales of Warranty or Service Contracts.