

TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 22-08

**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 information and data processing 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**

[REDACTED - TAXPAYER] (the "Taxpayer") is a [INDUSTRY SPECIFIC] data and technology company organized under Tennessee law and headquartered in [CITY], Tennessee. The Taxpayer offers a variety of [INDUSTRY SPECIFIC] license and credential verification, [INDUSTRY SPECIFIC ACTIVITY], and compliance monitoring services to its customers.

The key component of the Taxpayer's services is its proprietary data set. The Taxpayer builds the data set by obtaining data relating to [INDUSTRY SPECIFIC ENTITIES] published by [STATE AND FEDERAL GOVERNMENT ENTITIES]. The Taxpayer then uses a variety of automated and manual processes to verify, augment, and enhance that data.<sup>1</sup> The Taxpayer's data set is constantly updated. The Taxpayer uses this data set to provide compliance monitoring services to its customers.

The Taxpayer offers four services to its customers: [OFFERING 1, OFFERING 2, OFFERING 3, AND OFFERING 4]. The scope and extent of each of the Taxpayer's services differs slightly, but each service uses the Taxpayer's proprietary data set to provide compliance monitoring.

#### *[OFFERING 1]*

[OFFERING 1] is a continuous [RECORDS CHECKING] service that allows the Taxpayer's customers to discover disciplinary orders, licensing issues, administrative actions, and other issues related to the customers' employees. Customers using [OFFERING 1] are purchasing access to the Taxpayer's proprietary data set and related services.

To use [OFFERING 1], a customer periodically uploads its employee information to the Taxpayer's server either manually or automatically using its own human resources information system ("HRIS") software. The Taxpayer does not provide HRIS software to its customers, and it does not provide its customers with any software code to facilitate the transfer of data from the customers' HRIS software to the Taxpayer's servers. Instead, the Taxpayer tells its customers the categories of employee information that should be uploaded to the servers, and the customers must either write code to facilitate that transfer themselves or engage a third party such as the HRIS provider to write that code for them.

After a [OFFERING 1] customer uploads its employee information to the Taxpayer's servers, the Taxpayer continuously compares that information to its proprietary data set to determine whether the employee information matches any of the disciplinary, licensing, or administrative information in the data set. If there is a match, the Taxpayer sends an email informing the customer of the match.

To view the [RECORDS CHECKING] results, a [OFFERING 1] customer logs on to the Taxpayer's secure, online portal. The online portal does not provide any functionality to the customer other than allowing the customer to upload employee information and providing access to background check results.

The Taxpayer generally charges [OFFERING 1] customers a one-time fee for initial onboarding and implementation when the customers begin receiving the service.<sup>2</sup> In addition, customers pay a monthly fee for the [OFFERING 1] service based on the volume of employee data they upload to the Taxpayer's servers.

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<sup>1</sup> Data comes from a variety of sources, and each source often has an incomplete data set. Information from all sources is compared to form a more complete record to improve the data set.

<sup>2</sup> The onboarding and implementation fee is not for any taxable tangible personal property or services. Onboarding and implementation involves the Taxpayer setting up the online portal for the customer with logins, permissions, and a customized interface known as a dashboard. The Taxpayer monitors the customer's uploading process and provides help to the customer regarding the proper process for uploading data.

### *[OFFERING 2]*

The Taxpayer's [OFFERING 2] service is substantially similar to [OFFERING 1], except, instead of focusing on employee issues, it allows [INDUSTRY SPECIFIC] customers to continuously verify that their vendors are [ELIGIBLE TO CONTINUE TO PROVIDE SERVICES PAID FOR BY] [GOVERNMENT PROGRAMS]. Each [OFFERING 2] customer periodically uploads its vendor information to the Taxpayer's server, and the Taxpayer continuously compares that information to its proprietary data set to determine whether any of the customer's vendor's may be [INELIGIBLE TO PARTICIPATE] in a [GOVERNMENT PROGRAM]. If it appears that a vendor may be [INELIGIBLE] from such a program, the customer is notified by email and can view the relevant information through the Taxpayer's online portal. Customers receiving [OFFERING 2] services only use the online portal to upload vendor information and access information related to potential [INELIGIBILITY].

Most of the [OFFERING 2] customers pay for this service through an initial onboarding and implementation fee and a monthly fee based on the volume of vendor data they upload to the Taxpayer's servers. Some customers, however, choose to defer the cost of the service by participating in the Taxpayer's [OFFERING 2 - VENDOR PROGRAM]. Customers participating in this program pay the Taxpayer a fee to have the Taxpayer contact their vendors to ask the vendors to enroll in the [OFFERING 2 - VENDOR PROGRAM]. Most vendors that choose to enroll are also required to pay the Taxpayer an annual fee. The Taxpayer retains a portion of the vendor payments, but the remainder of those payments is applied to the applicable customer's [OFFERING 2] bill.<sup>3</sup>

### *[OFFERING 3]*

[OFFERING 3] is a service offered by the Taxpayer that is essentially a more limited version of [OFFERING 1] and [OFFERING 2]. While the [OFFERING 1] and [OFFERING 2] services allow for continuous comparison of customers' employee and vendor information with the Taxpayer's proprietary data set, [OFFERING 3] is a less expensive service that allows customers to perform discrete searches of the proprietary data set to see whether any of their employees or vendors may be [INELIGIBLE TO PARTICIPATE IN] in [GOVERNMENT PROGRAMS].

Most [OFFERING 3] customers enter individual employee or vendor information or upload a bulk file of that information through the Taxpayer's online portal and then view the search results using the portal. Some customers receive the [OFFERING 3] services through the use of an application programming interface ("API"). This integration method allows secure and real-time data transfer between two or more unrelated software systems. The API acts as a digital "key" that allows a customer to access the Taxpayer's web-based [OFFERING 3] protocol on the customer's own software platforms without separately opening a web browser. There is no additional charge for utilizing the API, nor is there a difference in cost for using the API as opposed to the online portal. Regardless of whether an [OFFERING 3] customer uses the online portal or an API, the service the customer receives is access to and the ability to search the Taxpayer's proprietary data set. Without the data set, neither the online portal nor the API would be of any use to the [OFFERING 3] customers. Customers pay a monthly fee for the Taxpayer's [OFFERING 3] service based on the number of searches performed.

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<sup>3</sup> Each vendor that enrolls in [OFFERING 2 - VENDOR PROGRAM] is listed on [TAXPAYER'S] online [REDACTED] directory. No sales are processed or otherwise facilitated through this directory. Instead, the [REDACTED] is an online directory that [INDUSTRY SPECIFIC] companies can use, without charge, to find vendors of particular products and services.

#### [OFFERING 4]

The Taxpayer also offers [OFFERING 4], which is a service similar to [OFFERING 3], primarily provided to [INDUSTRY SPECIFIC] customers to monitor their [NETWORKS]. The Taxpayer's [OFFERING 4] customers use an API to upload information on their [NETWORKS] and search the Taxpayer's proprietary data set to see whether any members of the [NETWORKS] may be [INELIGIBLE TO PARTICIPATE] in a [GOVERNMENT PROGRAM]. The API is sent from the Taxpayer to the customer, and the customer installs the API on their own system. There is no additional charge for the API.

The [OFFERING 4] customers can view the search results on their own software platforms using the API, or they can view the results on the Taxpayer's online portal. The sole purpose of the API and the online portal is to allow customers access to and the ability to search the Taxpayer's proprietary data set. The Taxpayer charges [OFFERING 4] customers an initial onboarding and implementation fee and a monthly fee based on the number of searches performed.

#### RULINGS

1. Are the Taxpayer's sales of its [OFFERING 1, OFFERING 2, OFFERING 3, AND OFFERING 4] services subject to Tennessee sales and use tax?

Ruling: No. The Taxpayer's sales of its [OFFERING 1, OFFERING 2, OFFERING 3, AND OFFERING 4] are sales of information or data processing services and are not subject to Tennessee sales and use tax.

#### ANALYSIS

The Taxpayer is providing information and data processing services which are not subject to Tennessee sales and use tax. Under the Retailers' Sales Tax Act,<sup>4</sup> all sales of tangible personal property, specified digital products,<sup>5</sup> remotely accessed software,<sup>6</sup> and specifically enumerated services are subject to sales and use tax, unless an exemption applies. Subscriptions to information or data processing services, including the capability of the customer to analyze such information or data from the dealer, are excluded from specified digital products subject to tax under TENN. CODE ANN. § 67-6-233(d) (2018).<sup>7</sup> Furthermore, TENN. CODE ANN. § 67-6-231(b) (2018), which provides for the taxation of remotely accessed software, reiterates that information or data processing services are not subject to sales and use tax.

Building a proprietary database from various sources of information and providing customers access to that database is a type of information service. Taking customers' uploaded data, systematically comparing that data to the database, and providing the customers with any matches between the

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<sup>4</sup> 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 (2018 & Supp. 2021)).

<sup>5</sup> TENN. CODE ANN. § 67-6-233 (2018).

<sup>6</sup> TENN. CODE ANN. § 67-6-231 (2018).

<sup>7</sup> See also TENN. CODE ANN. § 67-6-102(96)(B) (Supp. 2021) specifically excluding information and data processing services from the definition of "telecommunications service," which is a taxable service under Tenn. Code Ann. § 67-6-205(c)(3) (Supp. 2021).

uploaded data and the database is a data processing service. [OFFERING 1, OFFERING 2, OFFERING 3, AND OFFERING 4] services provide information or data processing services because they all compare the customers' uploaded data to the Taxpayer's database and then allow the customers to view that information. As such, [OFFERING 1, OFFERING 2, OFFERING 3, AND OFFERING 4] services are not subject to sales or use tax.

The customers access the [OFFERING 1, OFFERING 2, OFFERING 3, AND OFFERING 4] services either through the Taxpayer's online portal or through an API, and the portal and API could broadly be seen as taxable computer software.<sup>8</sup> However, use of the online portal or API is merely incidental to the non-taxable services considering that there is no additional charge for the API, the online portal and the API are only being used to gain access to the non-taxable services, and the online portal and the API are worthless to the Taxpayer without those non-taxable services.

Under the true object test that is used to determine the taxability of a product that involves taxable and non-taxable items, when the non-taxable component is the true object, and the taxable components are merely incidental, the transaction is not subject to sales and use tax.<sup>9</sup> Therefore, the incidental use of the online portal or the API to access the [OFFERING 1, OFFERING 2, OFFERING 3, AND OFFERING 4] services does not subject the Taxpayer's offerings to the Tennessee sales and use tax.

APPROVED: David Gerregano  
Commissioner of Revenue

DATE: 10/12/2022

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<sup>8</sup> Computer software is a set of coded instructions designed to cause a computer to perform a task. TENN. CODE ANN. § 67-6-102(18).

<sup>9</sup> See *generally* Tenn. Dept. of Rev. Ltr. Rul. 14-10 (Oct. 14, 2014) for an application and full analysis of the true object test.