

TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 23-01

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 live and on-demand fitness classes accessed online.

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] (the "Taxpayer") sells home exercise equipment that can connect to the internet. The Taxpayer also offers access to both live, instructor-led fitness classes and pre-recorded, on-demand fitness classes that can be streamed through a video screen attached to the exercise equipment or the display of any internet connected device. Customers within and outside Tennessee (the "Users") gain access to the classes by purchasing online memberships sold by the Taxpayer. Users may

purchase the home exercise equipment without purchasing a membership, and they may purchase a membership without purchasing the home exercise equipment.

The live and on-demand classes are sold together for a non-itemized membership fee that can be billed monthly or yearly. During classes, Users are provided with feedback from their internet connected devices or exercise equipment about their individual performance and can compare their individual performance to other Users participating in the same class. During a live class, the performance information for all Users in the class is posted on a leaderboard screen and includes biometric information analysis through the use of data points such as heartrate, calorie burn, and distance traveled. On-demand classes allow Users to compare their performance against the other participants who took the live version of the class. The Taxpayer offers many live, instructor-led classes at all hours that subscribers can attend, and those classes are recorded for later use. Thousands of pre-recorded, on-demand classes can be accessed by Users anytime.

RULINGS

1. Are the Taxpayer's membership fees for access to its online fitness classes subject to Tennessee sales and use tax?

Ruling: Yes. The membership fees are subject to Tennessee sales and use tax as a transaction that includes taxable specified digital products.

2. Does the interactive nature of the Taxpayer's offerings remove its classes from being classified as "specified digital products?"

Ruling: No. The pre-recorded on-demand classes are specified digital products subject to Tennessee sales and use tax.

3. Are the membership fees exempt if they include data processing and information services?

Ruling: No. The performance information provided by the Taxpayer for both types of classes is incidental to the sale of the classes. Furthermore, even if deemed a separate product that is included in the sale, the inclusion of nontaxable services in a bundled transaction that includes taxable products does not cause the entire transaction to be exempt from tax.

ANALYSIS

1. *The membership fees are subject to Tennessee sales and use tax.*

The Taxpayer's membership fees are subject to Tennessee sales and use tax because the pre-recorded classes included with the membership are taxable specified digital products. When the pre-recorded classes are included in a transaction involving other products, the entire transaction is subject to sales and use tax.

Pre-recorded on-demand classes are subject to sales and use tax because they qualify as specified digital products.¹ Taxable specified digital products include electronically transferred digital audio-visual works.² Digital audio-visual works are works of moving pictures combined with sound.³ In this instance, fitness classes that are recorded to provide Users with on-demand access are moving pictures combined with sound, making them taxable digital audio-visual works.⁴ These pre-recorded classes are very similar to work-out videos or DVDs that can be viewed at one's convenience; however, the tangible tape or disc has been replaced with online access. Essentially, this means that the transaction is taxable whether the product is delivered in tangible or digital form. Consequently, membership fees that include access to the thousands of pre-recorded on-demand fitness classes are subject to sales and use tax.

In Tennessee, whenever two or more separate products are sold for one non-itemized price and at least one of the products is subject to sales tax, the entire sales price is subject to sales tax.⁵ 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."⁶

This approach is generally applied when non-taxable services are combined with taxable products.⁷ For example, in the unreported case of *Tomkats Catering, Inc. v. Johnson*,⁸ a catering company included one server per banquet table in the cost of its banquet food, while also providing the option of hiring additional servers for a separate cost that was itemized on the invoice. The taxpayer argued that the optional services were non-taxable service contracts severable from the catering contracts because the charges for the optional services were separately invoiced.⁹ The court ruled that the costs of the optional services were separable and divisible from the food and, therefore, not taxable.¹⁰ Had the services not been optional and separately stated, they would have been taxed as part of a bundled sale of food and services.

¹ TENN. CODE ANN. § 67-6-233(b)(2).

² TENN. CODE ANN. § 67-6-102(94) (2022).

³ "Digital audio-visual works" means 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. TENN. CODE ANN. § 67-6-102(30).

⁴ See Tenn. Dept. Rev. Ltr. Rul. 17-18 (ruling that pre-recorded online training courses accessed via a monthly subscription are specified digital products subject to Tennessee sales and use tax).

⁵ See TENN. CODE ANN. § 67-6-102(87)(A)(vi) (defining sales price); see also *Magnavox Consumer Electronics v. King*, 707 S.W. 2d 504 (Tenn. 1986) (holding that where fuel costs are included in the agreed rental price of equipment, the entire lease payment is subject to the use tax); Cf *Penske Truck Leasing Co., L.P. v. Huddleston*, 795 S.W. 2d 669 (Tenn. 1990) (concluding that, in a suit involving a lease of vehicles, the lease of equipment agreement and the fuel sales agreement are separate parts of a divisible contract, therefore the fuel receipts must be considered separately from the fixed rental rate and the fixed mileage rate).

⁶ TENN. CODE ANN. § 67-6-102(87)(A)(vi).

⁷ See generally Tenn. Dept. Rev. Ltr. Rul. 14-10 (Oct. 13, 2014).

⁸ No. M2000-03107-COA-R3-CV, 2001 WL 1090516 (Tenn. Ct. App. Sep. 19, 2001).

⁹ *Id.* at *1.

¹⁰ *Id.* at *2.

The Taxpayer's on-demand classes are subject to sales and use tax as specified digital products. Because they are included with the membership and the membership is sold for one non-itemized price, the entire transaction is subject to sales and use tax.

It is useful to note that live, online, instructor led classes are generally not subject to sales and use tax in Tennessee.¹¹ The Taxpayer has suggested that the membership fees are subject to the amusement tax pursuant to TENN. CODE ANN. § 67-6-212 and has inquired as to whether an exemption to the amusement tax found in TENN. CODE ANN. § 67-6-330 applies to the online memberships it sells. The exemption applies to sales and use taxes imposed on various amusements and activities listed in TENN. CODE ANN. § 67-6-212. Regardless of whether the live, online instructor led classes are not subject to sales and use tax, or if they are exempt from sales and use tax, the Taxpayer's membership fees are still subject to sales and use tax because they include the sale of specified digital products.

2. *The interactive nature of the Taxpayer's offerings does not remove its pre-recorded classes from being classified as "specified digital products".*

The Taxpayer has also inquired as to whether the interactive and participatory nature of the online classes removes the Taxpayer's classes from being considered specified digital products. As explained above, the membership fee is subject to sales and use tax because the membership includes access to taxable pre-recorded, on-demand classes. As discussed, the pre-recorded online classes are more akin to buying pre-recorded work-out videos, which similarly are subject to sales and use tax regardless of the buyer's level of interaction with the video.

3. *The primary purpose of the transaction at issue is not data processing and information services.*

Lastly, the Taxpayer has inquired as to whether the membership fees may be exempt because they include the biometric tracking of the User and the display of leaderboard information, which the Taxpayer suggests is tax exempt data processing and information services. TENN. CODE ANN. § 67-6-233(d) (2022) provides that "subscriptions to data processing and information services that allow data to be generated, acquired, stored, processed or retrieved and delivered by electronic transmission to a purchaser, where the purchaser's primary purpose for the underlying transaction is the processed data or information, are excluded from specified digital products ..." (Emphasis added).

Even if the Taxpayer's biometric tracking and leaderboard functions could be considered data processing and information services, those functions are not the purchaser's primary purpose for the underlying transaction. The purchaser's primary purpose for the underlying transaction is to gain access to live and pre-recorded fitness classes. Without the classes, the memberships have no value. While the biometric data and leaderboard may provide value to the Users, that value is only incidental to the Users' access to the classes. Furthermore, even if the Taxpayer's biometric tracking and leaderboard functions were deemed a separate product that is included in the sale, the inclusion of non-taxable services in a bundled transaction that includes taxable products does not cause the entire transaction to be exempt from tax.¹² The inclusion of biometric tracking and leaderboard information does not alter the taxability of the transaction, which includes taxable specified digital products.

¹¹ See, e.g., Tenn. Dept. Rev. Ltr. Rul. 20-04 (June 10, 2020) and Tenn. Dept. Rev. Rev. Rul. 17-17 (Oct. 31, 2017).

¹² *Supra* note 5.

Approved:

David Gerregano
Commissioner of Revenue

Date:

3/9/2023