

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 16-04**

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 remotely accessed software.

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 qualified data center as defined in TENN. CODE ANN. § 67-6-102(73) (Supp. 2015) headquartered in [REDACTED] and provides [REDACTED] services to [REDACTED-CUSTOMERS] across the United States. [REDACTED].

Services Provided at the Data Center

The Taxpayer uses the technology infrastructure at its data center to process, store, network, manage and distribute data for its customers. The Taxpayer's customers access the data center network through a variety of means, including electronically, to send and receive data from the Taxpayer.

The Taxpayer collects the data received from its customers and uses both software that it internally develops (the "Internally-Developed Software") and software that it purchases from third parties (the "Third-Party Software") to format the data into the requested output. The Taxpayer's customers do not choose which software programs the Taxpayer uses in providing its services, have no rights to the software programs used, and do not enter into any licensing or subscription agreement with the Taxpayer for use or access to the software.

The Taxpayer provides services specific to five separate functions in the [REDACTED] services business: [REDACTED].

The [REDACTED] function includes [REDACTED]. The Taxpayer processes [REDACTED] information to facilitate [REDACTED].

The [REDACTED] function includes [REDACTED]. The Taxpayer processes [REDACTED] to facilitate [REDACTED].

The [REDACTED] function includes processing data necessary to [REDACTED] information. The Taxpayer processes [REDACTED] information, which is used to [REDACTED]. The data is aggregated and analyzed by [REDACTED].

The [REDACTED] function includes the processes necessary to facilitate [REDACTED]. The Taxpayer processes and stores [REDACTED] information to facilitate [REDACTED].

The [REDACTED] function includes processes necessary to [REDACTED]. The Taxpayer processes and stores [REDACTED] data to meet the [REDACTED] needs of its customers.

The Taxpayer also provides services related to a number of miscellaneous functions that include, but are not limited to [REDACTED]. The Taxpayer charges its customers a fee related to each of these functions and services.

Affiliate Accessed Software

Separate and apart from the above, the Taxpayer charges affiliated companies as defined in TENN. CODE ANN. § 67-6-395(c) (Supp. 2015) for their remote access to both Third-Party Software and Internally-Developed Software. In some cases, when an affiliated company purchases such access to software from the Taxpayer, it subsequently charges another affiliate of the Taxpayer for access to that software.

RULINGS

1. Are the Taxpayer's charges for the services that it provides at its data center subject to the Tennessee sales and use tax?

Ruling: No. The Taxpayer's charges for the services that it provides at its data center are not subject to the Tennessee sales and use tax because the Taxpayer is providing non-taxable information and data processing services.

2. Are the Taxpayer's charges to its affiliates for remote access and use of Third-Party Software and Internally-Developed Software and those affiliates' subsequent charges to other affiliates of the Taxpayer for remote access and use of the same software subject to the Tennessee sales and use tax?

Ruling: No. The Taxpayer's charges to its affiliates for remote access and use of Third-Party Software and Internally-Developed Software are not subject to the Tennessee sales and use tax. Moreover, those affiliates' charges to other affiliates of the Taxpayer for remote access and use of the same software are also not subject to the Tennessee sales and use tax.

ANALYSIS

1. PROVISION OF SERVICES AT THE DATA CENTER

- A. BACKGROUND

Under the Retailers' Sales Tax Act,¹ the retail sale in Tennessee of tangible personal property and specifically enumerated services is 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."²

TENN. CODE ANN. § 67-6-102(78)(A) (Supp. 2015) 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."³

¹ 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 (2013)).

² TENN. CODE ANN. § 67-6-102(76) (Supp. 2015).

³ 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).

With regard to prewritten computer software, TENN. CODE ANN. § 67-6-102(68) 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

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.⁴ 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 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.⁵

“Computer software” is “a set of coded instructions designed to cause a computer . . . to perform a task.”⁶ Computer software is “delivered electronically” if delivered “by means other than tangible storage media.”⁷ The Tennessee Supreme Court has stated that the fabrication of, or customized modification or enhancement to, computer software is considered a taxable sale of computer software.⁸

Additionally, 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.⁹

In response to advances in technology that allow persons to remotely access and use software over the Internet, the Tennessee General Assembly adopted into law 2015 Tenn. Pub. Acts Ch. 514, § 22 (effective July 1, 2015). This new law effectively treats all purchases of computer software in this state equally, regardless of how the software is provided to and used by a purchaser in this state. It amends TENN. CODE ANN. § 67-6-231(a) to include a new subdivision (2), which states in pertinent part that

[f]or purposes of subdivision (a)(1), “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

price given to the purchaser for the modification or enhancement, the modification or enhancement shall not constitute prewritten computer software.” TENN. CODE ANN. § 67-6-102(68),

⁴ TENN. CODE ANN. § 67-6-102(78)(C).

⁵ TENN. CODE ANN. § 67-6-231(a)(1) (Supp. 2015). 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).

⁶ TENN. CODE ANN. § 67-6-102(18).

⁷ TENN. CODE ANN. § 67-6-102(24).

⁸ See *Creasy Sys. Consultants, Inc. v. Olsen*, 716 S.W.2d 35, 36 (Tenn. 1986).

⁹ TENN. CODE ANN. § 67-6-102(78)(K).

access shall be deemed equivalent to the sale of licensing of the software and electronic delivery of the software for use in the state.

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 1977,¹⁰ remains subject to sales and use tax regardless of a customer's chosen method of use.

The sales tax also applies to retail sales of services specifically enumerated in the Retailers' Sales Tax Act.¹¹ Notably, 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.¹² As reassurance of this fact, the General Assembly included language in Section 22 stating that nothing in the new subdivision (a)(2) 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.¹³

Therefore, while the new TENN. CODE ANN. § 67-6-231(a)(2) 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.¹⁴ Finally, when a transaction involves taxable and nontaxable components and the transaction's true

¹⁰ 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 at 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).

¹¹ The Retailers' Sales Tax Act imposes the sales tax only on services specifically enumerated in the Act. *See, e.g.*, TENN. CODE ANN. § 67-6-205 (2013); *Covington Pike Toyota, Inc. v. Cardwell*, 829 S.W.2d 132, 135 (Tenn. 1992); *Ryder Truck Rental, Inc. v. Huddleston*, No. 91-3382-III, 1994 WL 420911, at *3 (Tenn. Ct. App. Aug. 12, 1994) (sales tax does not apply to all services; rather, it only applies to retail sales of services specifically enumerated by the statute).

¹² The Retailers' Sales Tax Act imposes the sales tax only on services specifically enumerated in the Act. *See, e.g.*, TENN. CODE ANN. § 67-6-205; *Covington Pike Toyota, Inc. v. Cardwell*, 829 S.W.2d 132, 135 (Tenn. 1992); *Ryder Truck Rental, Inc. v. Huddleston*, No. 91-3382-III, 1994 WL 420911, at *3 (Tenn. Ct. App. Aug. 12, 1994) (sales tax does not apply to all services; rather, it only applies to retail sales of services specifically enumerated by the statute).

¹³ 2015 Tenn. Pub. Acts Ch. 514, § 22 (codified at TENN. CODE ANN. § 67-6-231(a)(2) (Supp. 2015)).

¹⁴ *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), *available at* <http://www.tennessee.gov/assets/entities/revenue/attachments/14-10.pdf>.

object or a “crucial,”¹⁵ “essential,”¹⁶ “necessary,”¹⁷ “consequential,”¹⁸ or “integral”¹⁹ element of the transaction is subject tax, the entire transaction is subject to sales tax.²⁰ 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.²¹

B. APPLICATION TO THE TAXPAYER

The Taxpayer’s charges for the services provided by its data center are not subject to the Tennessee sales and use tax.

No sale, transfer, or electronic delivery of tangible personal property or computer software occurs in Tennessee when the Taxpayer charges its customers for the services provided by its data center. Although the Taxpayer utilizes Third-Party Software and Internally-Developed Software to perform the services at its data center, the Taxpayer does not transfer title, possession, or control of the software programs at any time, nor do its customers electronically download the software programs.

Moreover, the Taxpayer is not furnishing taxable services or things in Tennessee. As previously stated, only specifically enumerated services and things, such as the use of computer software, are subject to the Tennessee sales and use tax.

With respect to the taxable use of computer software that remains in possession of the dealer, TENN. CODE ANN. § 67-6-231(a)(2) requires the access and use of the computer software by a customer from a location in this state. In this instance, it is the Taxpayer that uses computer software to perform services through its data center. The electronic transfer of and access to the customer information to the data center is merely incidental to the Taxpayer’s provision of its services.

¹⁵ 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).

¹⁶ *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 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).

¹⁷ See *supra* note 16.

¹⁸ 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”).

¹⁹ See *AT&T Corp. v. Johnson*, 2002 WL 31247083, at *8.

²⁰ See generally *Ltr. Rul. No. 14-10*, *supra* note 15.

²¹ See generally *id.*

TENN. CODE ANN. § 67-6-231(a)(2) clarifies that the application of the sales and use tax to remotely-accessed software does not make otherwise nontaxable services subject to tax. One such service that TENN. CODE ANN. § 67-6-231(a)(2) specifically identifies as nontaxable is “information or data processing services.” The services identified above that the data center performs qualify as information or data processing services. The fact that the Taxpayer uses computer software to perform the information or data processing services is irrelevant. Thus, the software programs that the Taxpayer uses in the provision of services are not subject to tax as remotely accessed software.

Accordingly, the Taxpayer’s services performed by its data center are not subject to the Tennessee sales and use tax.

2. USE OF REMOTELY ACCESSED SOFTWARE BY AN AFFILIATED ENTITY

A. THIRD-PARTY SOFTWARE

Generally, if an entity purchases software from a third party and charges an affiliate for remote access and use of that software within Tennessee, such charges are subject to the Tennessee sales and use tax.²² However, the new subdivision (2) of TENN. CODE ANN. § 67-6-231(a) added by 2015 Tenn. Pub. Acts Ch. 514, § 22 (effective July 1, 2015) sets forth an exception with respect to a qualified data center. TENN. CODE ANN. § 67-6-231(a)(2) provides that “software purchased by a qualified data center for access and use by an affiliated company, as defined by § 67-6-395(c), shall be deemed to be used and consumed by the qualified data center and not resold to the affiliate company.”²³

Thus, effective for all billing periods beginning on or after July 1, 2015, when the Taxpayer, a qualified data center as defined in TENN. CODE ANN § 67-6-102(73), purchases Third-Party Software for remote access and use by entities that qualify as its affiliates under TENN. CODE ANN. § 67-6-395(c), it is deemed the end user and consumer of that software. It follows that no taxable sale occurs when an affiliate of the Taxpayer remotely accesses and uses that software regardless of the manner of payment for such access.

Accordingly, the Taxpayer’s charge to an affiliated company for remote access to Third-Party Software and that affiliate’s subsequent charge to another affiliate of the Taxpayer for remote access to such software are not subject to the Tennessee sales and use tax.

B. INTERNALLY-DEVELOPED SOFTWARE

2015 Tenn. Pub. Acts Ch. 514, § 25 (effective July 1, 2015) exempts from the Tennessee sales and use tax an entity’s use of software internally developed by an affiliate through its amendment of TENN. CODE ANN. § 67-6-395(a). TENN. CODE ANN. § 67-6-395(a) (Supp. 2015) provides that “[t]here is exempt from the tax imposed by this chapter the use of computer software that is developed and fabricated

²² See TENN. CODE ANN. § 67-6-231(a)(2).

²³ TENN. CODE ANN. § 67-6-231(a)(2).

by an affiliated company, regardless of whether such software is accessed and used as described in § 67-6-231(a)(2) or delivered by other means.”

Thus, for all billing periods beginning on or after July 1, 2015, when the Taxpayer charges its affiliates as defined in TENN. CODE ANN. § 67-6-395(c) for remote access and use of Internally-Developed Software that it hosts on its servers, such use is exempt from the Tennessee sales and use tax. It follows that when that affiliate subsequently charges another affiliate of the Taxpayer for remote access and use of such software, such use is also exempt from the Tennessee sales and use tax.

Gary Williams
Assistant General Counsel

APPROVED: Richard H. Roberts
Commissioner of Revenue

DATE: June 8, 2016