

AN ALERT FROM THE BDO STATE AND LOCAL TAX PRACTICE

BDO KNOWS:

SALT



SUBJECT

NEW GUIDANCE ISSUED FOR TENNESSEE'S SALES AND USE TAX FOR REMOTELY ACCESSED SOFTWARE

SUMMARY

The Tennessee Department of Revenue recently issued five letter rulings that address the application of Tennessee's sales and use tax on remotely accessed software. The tax was enacted as part of the 2015 Revenue Modernization Act, H.B. 644, 109th Gen. Assem. (Tenn. 2015) (enacted) ("RMA"), and applies to transactions occurring after June 30, 2015. See the [BDO SALT Alert](#) that discusses the RMA.

DETAILS

Tennessee's Sales and Use Tax on Remotely Accessed Software

Under the RMA, Tennessee amended its law to tax computer software stored on a server as a "deemed equivalent to the sale or licensing of the software and electronic delivery of the software," effective for transactions occurring after June 30, 2015. Where use of the software occurs in multiple states, Tennessee allows a seller or customer to allocate the sales price of the software based upon the percentage of users in the state to determine the portion taxable in Tennessee.

The RMA specifically provides that the tax on remotely accessed software does not apply to any services that are not currently subject to the tax, such as: (i) information or data processing services, (ii) payment or transaction processing services, (iii) payroll processing services, (iv) billing and collection services, (v) Internet access, (vi) the storage of data, digital codes, or computer software, or (vii) the service of converting, managing, and distributing digital products. In addition, the RMA provides for an exemption for a "dealer that purchases computer software only for the purpose of reselling access and use of such software," except where it is purchased by a qualified data center for access and use by an affiliated company.

CONTACT:

ATLANTIC:

JONATHAN LISS, Tax Senior Director
215-636-5502 / jliiss@bdo.com

JEREMY MIGLIARA, Tax Senior Director
703-770-0596 / jmigliara@bdo.com

CENTRAL:

ANGELA ACOSTA, Tax Senior Director
248-688-3313 / aacosta@bdo.com

NICK BOGEL, Tax Senior Director
414-615-6773 / nbogel@bdo.com

JOE CARR, Tax Principal
312-616-3946 / jcarr@bdo.com

MARIANO SORI, Tax Partner
312-616-4654 / msori@bdo.com

RICHARD SPENGLER, Tax Senior Director
616-776-3687 / rspengler@bdo.com

NORTHEAST:

JANET BERNIER, Tax Principal
212-515-5405 / jbernier@bdo.com

MATTHEW DYMENT, Tax Principal
617-239-4130 / mdyment@bdo.com

SOUTHEAST:

ASHLEY MORRIS, Tax Senior Director
919-278-1963 / amorris@bdo.com

SCOTT SMITH, Tax Senior Director
615-493-5629 / ssmith@bdo.com

SOUTHWEST:

TOM SMITH, Tax Partner
918-281-4080 / tasmith@bdo.com

GENE HEATLY, Tax Senior Director
214-665-0716 / gheatly@bdo.com

WEST:

ROCKY CUMMINGS, Tax Partner
415-490-3130 / rcummings@bdo.com

PAUL MCGOVERN, Tax Senior Director
714-913-2592 / pmcgovern@bdo.com

In Sales and Use Tax Notice # 15-14 (Jun. 2015) (updated Dec. 2015), the Department instructs sellers to collect tax on the sale of remotely accessed software used within and without Tennessee, unless the seller receives a Streamlined Sales and Use Tax Certificate of Exemption (which does not require that the customer have a Tennessee sales and use tax account number) or a Remotely Accessed Software Direct Pay Permit (which requires that the customer have a Tennessee sales and use tax account number) from the customer for purposes of documenting the portion of the price that corresponds to the percentage of exempt users located outside Tennessee. In case of the receipt of the former, the seller collects tax on the portion of the purchase price that relates to use in the state only. In the case the receipt of the latter, the seller is not required to collect tax at all. In Sales and Use Tax Notice # 15-24 (Dec. 2015), the Department informs taxpayers that it released a new Remotely Accessed Software Direct Pay Permit form, and instructs taxpayers on its use.

Letter Ruling # 15-07 (Nov. 23, 2015)

Use of Same Software, but for Different "True Objects"

FACTS: The taxpayer sells two types of software packages that assist in the management of its clients: a Subscription Package and Business Process Outsourcing Package. Under the Subscription Package, a customer accesses the taxpayer's proprietary software housed on servers outside Tennessee via a web portal. The software enables the customer to upload information and related documents, which then populates key data fields. The customer may then view the documents and perform various actions. With respect to the Business Process Outsourcing Package, a customer uses the same software as the Subscription Package, but the taxpayer provides services that the customer would perform under the Subscription Package.

RULING: The Department ruled the Subscription Package was a taxable sale or use of software, and declined to apply the "true object" test because "the sole value of the Subscription Package is the access to the software." Conversely, the Department ruled that the Business Process Outsourcing Package was not subject to tax because the "true object" of the Business Process Outsourcing Package is the provision of nontaxable services.

Letter Ruling # 15-08 (Dec. 17, 2015)

Multiple Software Applications Ruled Non-Taxable Services

FACTS: The taxpayer purchases remotely accessed software that it uses in Tennessee and other states for purposes of providing services to customers. The taxpayer sells the following web-based services to its customers through affiliates located within and without the state: information management service, remote storage service, electronic delivery service, payment management service, and web-based information service.

In connection with providing these services, the customer may be able to deliver, access, view, or receive information online through a portal via software provided by the taxpayer. In addition, the customer may be separately charged for the following, which the taxpayer also sells: online storage, system configuration, stand-alone remotely accessed software, and other items.

RULING: The Department ruled that all of the services sold by the taxpayer are non-taxable because the "true object" is the provision of nontaxable services. It found the customer's access to the taxpayer's portal operating software to be an "incidental medium for transmission of the taxpayer's nontaxable services."

The Department then ruled that the full sales price of the taxpayer's remotely accessed software is subject to tax for any billing period beginning after June 30, 2015, if the taxpayer has notice that the customer is using the software in the state. However, if the taxpayer receives a Streamlined Sales and Use Tax Certificate of Exemption, then it is only required to collect sales tax the portion of the sales price as indicated on the certificate. If the taxpayer receives a Remotely Accessed Software Direct Pay Permit from the customer, then the taxpayer should not collect any tax.

With respect to the taxpayer's purchases of software, the Department ruled that if the taxpayer provides a Remotely Accessed Software Direct Pay Permit to the seller, it must remit tax on the portion of the sales price allocated to Tennessee users. If the taxpayer provides a Streamlined Sales and Use Tax Certificate of Exemption to the seller, it must pay tax to the seller based on the percentage of taxpayer's users in Tennessee.

Letter Ruling # 15-09 (Dec. 17, 2015)

Taxable and Non-Taxable Affiliate-Hosted, Vendor-Hosted and Internally-Hosted Software

FACTS: The taxpayer is comprised of a non-Tennessee headquartered corporation that has business units within and without Tennessee, and a limited liability company disregarded for federal income tax purposes that is headquartered and operates out of Tennessee. The taxpayer purchases affiliate-hosted software, vendor-hosted software, and internally-hosted software.

The taxpayer purchases the affiliate-hosted software from foreign affiliates that purchase the software from third-party vendors, and host the software on servers in foreign countries. In conjunction with the software, a foreign affiliate provides the following services the charge for which is bundled with the software, determined on a per-seat basis, and billed to each business unit of the taxpayer: hosting applications and data services, application monitoring, data storage, and backups, disaster recovery, technical support, and incident management. The taxpayer's employees may use the software to input, manipulate or process data, or run reports, and remotely access the software via a desktop icon, an application platform, or an intranet or web-based link.

The taxpayer purchases subscriptions to the vendor-hosted software from third-party vendors. The taxpayer is billed for subscription costs at its headquarters located outside Tennessee, which the taxpayer then allocates to each of its internal business units located within and without Tennessee. The software remains in the possession of the third-party vendor on servers located outside Tennessee, which the taxpayer's employees within and without Tennessee access via a web browser to perform various functions that may be done on behalf of the taxpayer's business units throughout the country, Tennessee included.

The taxpayer purchases the internally-hosted software from third-party vendors, which the taxpayer then downloads or installs on computers or servers located within and without Tennessee. The taxpayer passes the charges for the software, along with any related costs, to each of its business units as an intercompany expense.

RULING: The Department noted that every person that accesses and uses software sold in any particular transaction is considered a user, and ruled that the taxpayer is responsible for reporting and remitting tax due on the purchase price of the affiliate-hosted software and related bundled services to the extent used by a business unit in the state.

Next, the Department ruled that the vendor-hosted software is subject to tax to the extent access and use is attributable to users in Tennessee. The Department noted that the seller is not obligated to collect tax on the sale if it is not readily apparent that the taxpayer is accessing and using the software in Tennessee or if the taxpayer provides the seller with a Remotely Accessed Software Direct Pay Permit. If the taxpayer presents the seller with a Streamlined Sales and Use Tax Certificate of Exemption, the seller must collect and pay tax on the percentage of users located inside Tennessee based upon the residential street address or primary business address of each user.

Lastly, the Department ruled that the taxpayer's purchase of internally-hosted software is not subject to tax because it is purchased and hosted on servers located outside Tennessee, and no sale, lease, license or transfer of software occurs in Tennessee.

Letter Ruling # 16-01 (Jan. 26, 2016)

Taxable Access to Software

FACTS: The taxpayer provides its customers with web-based access to information on products, which allows a customer to review, make changes, or pull a report. The taxpayer does not separately charge the customer for access to the information. Rather, the access is part of the overall contract for services.

The taxpayer provides its customers with the option to subscribe to a web-based technology solution that allows the customer to manage and administer its own information. A customer accesses the solution through a hosted extranet site, and is separately billed for it. The taxpayer licenses the software from a third-party that hosts the software on its own servers, which the taxpayer then modifies to identify it as being provided by the taxpayer.

In order to provide services to customers, the taxpayer purchases and uses software applications that its employees remotely access from locations within and without Tennessee.

RULING: The Department ruled that the web access is not taxable because the use of the website is incidental to the taxpayer's provision of services (i.e., the "true object").

Next, the Department ruled that the taxpayer may license the web-based technology solution as an exempt sale for resale because the taxpayer is purchasing the license solely for the purpose of offering the software to its customers who must pay tax.

Lastly, the Department ruled that the seller should collect sales tax on the sale of software applications used by the taxpayer in providing services, unless it is not readily apparent that the taxpayer is accessing and using the software in Tennessee or if the taxpayer provides the seller with a Remotely Accessed Software Direct Pay Permit. If the taxpayer presents the seller with a Streamlined Sales and Use Tax Certificate of Exemption, the seller must collect and pay tax on the number of users located inside Tennessee based upon the residential street address or primary business address of each user.

Letter Ruling # 16-02 (Mar. 8, 2016)

Non-taxable Access to Software

FACTS: The taxpayer delivers electronically generated products on behalf of its clients, and uses data-gathering tools to create reports for clients. A client accesses the electronically generated products through a web-based interface that contains a layout design which allows the client to create electronically delivered products themselves and to specify to whom to send such products. In addition, the web-based interface allows a client to upload and manage their information on the taxpayer's system, and access data and analysis generated and compiled by the taxpayer. The taxpayer does not separately charge for web-based access.

The taxpayer had developed proprietary software that facilitates or automates these functions, which it stores on servers located in unnamed states. The taxpayer's employees determine what information is collected, how that information is best analyzed, and what information is automatically reported to clients through the web-based interface.

RULING: The Department considered the web-based interface to be computer software for sales and use tax purposes, but found the software to be incidental to the "true object" of the purchase - outsource the delivery of electronically generated products, and to receive reports and analytics. The web-based interface merely facilitates communication between the taxpayer and the client. Accordingly, the Department ruled that the product was a nontaxable service.

BDO INSIGHTS

- ▶ The Department of Revenue's letter rulings provide helpful guidance regarding the Department's application of the sales and use tax on remotely accessed software, including when the sale of such may be considered a non-taxable service performed "in the cloud," or a taxable sale or license of software delivered in Tennessee.
- ▶ Tennessee taxpayers that have not done so already should update their sales and use tax compliance systems and procedures for reporting and payment of the tax on remotely accessed software, and the Department's related guidance.

The Tax Practice at BDO is among the largest tax advisory practices in the United States. With 63 offices and more than 450 independent alliance firm locations in the United States, BDO has the bench strength and coverage to serve you.

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, advisory and consulting services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through 63 offices and over 450 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multinational clients through a global network of 1,408 offices in 154 countries.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information, please visit www.bdo.com.

Material discussed in this tax alert is meant to provide general information and should not be acted on without professional advice tailored to your firm's individual needs.