

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING #96-09**

**WARNING**

**Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.**

**SUBJECT**

Application of the sales and use tax to Internet access services provided by [THE TAXPAYER].

**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

[THE TAXPAYER] provides Internet access to a number of markets throughout the country, including Tennessee. Depending on the subscriber's location and choice of telecommunications service, a subscriber can access [THE TAXPAYER] by either dialing a local phone number, a long-distance phone number, or using a dedicated line. In most cases [THE TAXPAYER] can be accessed through a local call. In all cases, this initial connection is provided by the subscriber's telecommunications provider and paid for by the subscriber to the provider, such as the subscriber's local telephone company or long-distance provider. Once this initial connection is made, [THE TAXPAYER] uses telecommunication services purchased from a long distance carrier, such as MCI, to connect the caller to [THE TAXPAYER]'s server hardware in [NOT TENNESSEE], which then connects the subscriber to the Internet. All telecommunications subsequent to the initial connection are provided by [THE TAXPAYER] to the subscriber as part of the service purchased by the subscriber from [THE TAXPAYER]. As explained above, [THE TAXPAYER] purchases long-distance service as necessary from a long-distance provider in order to provide this service to its subscribers.

The following are examples of the types of charges [THE TAXPAYER] will make:

Flat Rate Monthly Charge - both "Dial-up" customers (i.e. customers that will use local access and long-distance telephone companies to connect to [THE TAXPAYER]) and "dedicated-line" customers (customers who have a direct line to [THE TAXPAYER]) will be provided access to an Internet provider. They will also have an unlimited number of hours of usage and/or access. Customers will be billed a flat monthly fee;

Installation Charge - both types of customers mentioned above will be charged a one-time installation/connection fee;

Hourly Charge - some marketing packages in the future may have an hourly usage component. For example, such a package may be \$12.95 per month and \$2.00 per hour of use in excess of eight hours;

Software, Modems, and Textbook Sales - software, modems, and textbooks may also be sold to customers;

Training and Consulting - training of a customer's employees on Internet use may be provided and a fee assessed. Consulting customers on the usefulness of

Internet may be another service. Any training or consulting will not be charged as part of the sale of tangible personal property or telecommunication or repair or other taxable service.

[THE TAXPAYER] will also provide World Wide Web Services. Customers will be set up with a database that can be accessed by other Internet users. When a customer desires to publish information on the World Wide Web Service, he is put in contact with a taxpayer representative in [NOT TENNESSEE]. Once the customer obtains a web site, he is given the name of the site location and a password. This database will be maintained on [THE TAXPAYER]'s server in [NOT TENNESSEE]. He is then free to transfer his material to this web site via the Internet (using an [NAME OF PROGRAM] program). An Internet connection is maintained so that the database can be accessed by other Internet users. A set-up charge and a per megabit of storage charge will be billed to these customers. Internet access for the subscriber is not provided as part of the World Wide Web Service. A subscriber would have to access his web site either through [THE TAXPAYER] as described above or from another Internet provider.

[THE TAXPAYER] maintains some hardware (Modems, CSU/DSU units, and Routers) in Tennessee on the premises of the local telephone companies in the markets it serves. All of its server hardware (i.e. the computers that run the Internet system) is located in [NOT TENNESSEE]. All billing is processed and sent out of [NOT TENNESSEE]. [THE TAXPAYER] solicits customers in Tennessee through the use of independent contractor sales agents. [THE TAXPAYER] is a corporation.

## **ISSUES**

[THE TAXPAYER] would like guidance as to whether any of the above-mentioned Internet services and sales are subject to the Tennessee retailer's sales and use tax or any other tax imposed on consumers or providers and administered by the Tennessee Department of Revenue, and whether the location of the customer (i.e., an out-of-state customer) impacts the tax result.

## **RULINGS**

Flat rate monthly charges, installation charges, and hourly charges are all subject to sales tax as charges for the sale of telecommunications services if the service is originated or received in this state and billed or charged to a service address in Tennessee. Charges for software, modems, and textbook sales are subject to tax if delivered to the purchaser in Tennessee. Charges for training and consulting as described are not subject to sales or use tax. Charges for World Wide Web Services are not subject to sales tax in Tennessee under the facts described.

Tennessee also imposes corporate franchise and excise taxes for which [THE TAXPAYER] will be liable.

## ANALYSIS

Under T.C.A. § 67-6-102(23)(F)(iii), the term “sale at retail” is defined to include the “furnishing, for a consideration, of either intrastate or interstate telecommunication services.” The term “telecommunication” is defined in T.C.A. § 67-6-102(29), which provides as follows:

- (A) "Telecommunication" means communication by electric or electronic transmission of impulses;
- (B) "Telecommunications" includes transmission by or through any media such as wires, cables, microwaves, radio waves, light waves, or any combination of those or similar media;
- (C) Except as provided in subdivision (D), "telecommunications" includes, but is not limited to, all types of telecommunication transmissions, such as telephone service, telegraph service, telephone service sold by hotels or motels to their customers or to others, telephone service sold by colleges and universities to their students or to others, telephone service sold by hospitals to their patients or to others, WATS service, paging service, and cable television service sold to customers or to others by hotels or motels;
- (D) "Telecommunications" does not include public pay telephone services, television or radio programs which are broadcast over the airwaves for public consumption, coaxial cable television (CATV) which is offered for public consumption, interstate WATS service, private line service, or automatic teller machine (ATM) service, wire transfer or other services provided by any corporation defined as a financial institution under § 67-4-804(a)(9), unless the company separately bills or charges its customers for specific telecommunication services rendered;

Under the definitions quoted above, Internet access services are interstate telecommunications services subject to tax on the sales price. The term “sales price” is defined by T.C.A. Section 67-6-102(25) to mean “the total amount for which a taxable service or tangible personal property is sold.” Applied to the facts presented, flat rate monthly charges, installation charges, and hourly charges would all be considered part of the sales price subject to tax if the service is provided in Tennessee.

In regard to interstate telecommunications services, T.C.A. Section 67-6-102(23)(F)(iii) provides that “[o]nly those charges for interstate telecommunication which are originated or received in this state and which are billed or charged to a service address in Tennessee shall be included in the tax base.” The term “service address” is defined by T.C.A. Section 67-6-102(26) to mean “a location of telecommunication equipment from which the telecommunication services are originated or at which telecommunication services are received by the consumers. In the event this may not be a defined location, as in the case of mobile telephones, paging systems, maritime systems, air to ground systems and the

like, "service address" means the location of the consumer's primary use of the telecommunication equipment as defined by the telephone number, authorization codes, or location in Tennessee where bills are sent." Therefore, the only telecommunications services taxable in Tennessee would be those originated or received in Tennessee and billed to a Tennessee service address.

[THE TAXPAYER'S] Internet service will be considered to be originated or received based on the point at which a subscriber accesses such service. If the subscriber can access such service by dialing a Tennessee local telephone number then [THE TAXPAYER]'s service will be considered to be originated or received in Tennessee. If the subscriber accesses such service by dialing a long-distance number within Tennessee or by dialing [THE TAXPAYER] without toll, such as by use of an 800 number, [THE TAXPAYER]'s service will also be considered to be originated or received in Tennessee. If the subscriber accesses [THE TAXPAYER]'s service by dialing an out-of-state long distance number at his own expense, or similarly uses a long distance private line or similar telecommunication to connect to [THE TAXPAYER] outside Tennessee at the subscriber's own expense, then in those instances [THE TAXPAYER]'s service will not be considered to be originated or received in Tennessee. Those telecommunications services originated or received in Tennessee as described above and billed to a Tennessee service address would be subject to sales tax.

The World Wide Web Service, as described in the facts, consists of maintaining a data file for the subscriber and an Internet connection so the file can be accessed by Internet users. This service as described includes a telecommunications component in the form of the Internet connection maintained by [THE TAXPAYER]. This connection is made, however, outside Tennessee and can only be accessed by someone purchasing access to the Internet through [THE TAXPAYER] as described above or through another Internet provider. T.C.A. Section 67-6-102 (23)(F)(iii) defines as a retail sale "[t]he furnishing, for a consideration, of either intrastate or interstate telecommunication services. Only those charges for interstate telecommunication which are originated or received in this state and which are billed or charged to a service address in Tennessee shall be included in the tax base." Since charges for World Wide Web Service do not involve an intrastate telecommunication in Tennessee they are not taxable as an intrastate telecommunication. As an interstate telecommunication, World Wide Web Service as provided by this taxpayer begins and ends outside Tennessee. The service begins at the location of the server, which is not in Tennessee, and ends at the location of the Internet connection, which is also outside Tennessee. Therefore, based on these facts, any telecommunications service provided as part of the World Wide Web Service as described is not provided in Tennessee.

Tennessee also imposes a corporate franchise tax, based on the value of assets in Tennessee and a corporate excise tax based on apportioned net earnings. T.C.A. §§ 67-4-806(a) and 67-4-903(a) impose these taxes on "[a]ll corporations, . . . organized for profit under the laws of this state or any other state or country and doing business in Tennessee . . ." Tennessee law does not define the term "doing business in Tennessee,"

however guidance is provided by Title 15 United States Code Annotated Section 381(a), which prohibits imposition of a net income tax when the taxpayer's only business in the taxing state is the solicitation of sales of tangible goods in interstate commerce. Title 15 U.S.C.S. Section 381(a) reads as follows:

(a) "No State . . . shall have power to impose . . . a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both of the following:

- (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
- (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer of such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1)."

In this case [THE TAXPAYER]'s activities go beyond the solicitation of orders in Tennessee. [THE TAXPAYER] maintains property in Tennessee, i.e., computer hardware (Modems, CSU/DSU units, and Routers) located on the premises of the local telephone companies in the markets it serves. [THE TAXPAYER] may also provide services in Tennessee in the form of training or consulting. Therefore, [THE TAXPAYER] will be subject to corporate franchise and excise taxes in Tennessee.

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APPROVED: Ruth E. Johnson

DATE: March 4, 1996

