

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 02-32**

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

The application of the sales and use tax to various software-related activities carried on by [NUMBER] vendors, all hired to assist in the implementation of a financial accounting software program.

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], through one of its divisions, is in the process of implementing [NAME], a financial accounting software program. [NUMBER] vendors will be assisting Taxpayer in training, modifying, integrating, consulting, designing, testing, and

performing other services relating to the [NAME] software and other software that will work in conjunction with [NAME]. Each of the [NUMBER] vendors performs one or more of the following:

1. Modification: changing the command codes/language of the original software. Modification will be done in Tennessee by vendor AB.¹
2. Programming: writing programs or command languages to integrate software. Programming will be performed in Tennessee by vendors E, G, L, T, V, Z, AB, AF, AI, AJ, and AK.
3. Integration of Software: inputting data that is integral to the installation process. Integration of software will be carried out in Tennessee by vendors C, E, G, J, L, M, O, S, T, V, Y, Z, AA, AB, AF, AI, AJ, and AK. Vendor O also sold software to Taxpayer.
4. Consultation and Meetings: meetings to gather information regarding project requirements/status. Consultations and meetings will be done in Tennessee by vendors B, U, W, and AE. These services were not provided as part of the sale of software.
5. Design: analysis of user needs and translating needs into instructions for use in programming. Design work will be carried out in Tennessee by vendors C, E, G, J, L, M, O, Q, R, S, T, V, Y, Z, AA, AB, AF, AI, AJ, and AK. Vendor O also sold software to Taxpayer.
6. Testing: testing of program to see if it performs required functions. Testing will be performed in Tennessee by vendors C, E, G, J, L, M, O, S, T, V, Y, Z, AA, AB, AE, AF, AI, AJ, and AK. Vendor O also sold software to Taxpayer.
7. Training: conducting training for software product. Training will be performed in Tennessee by vendors D and I.

Lastly, Taxpayer will reimburse some vendors for their out of pocket lodging, meal, and transportation expenses. Vendors B, C, D, E, G, I, J, K, M, O, S, T, U, V, Y, Z, AA, AE, AF, AI, AJ, and AK perform services in Tennessee and will be reimbursed. Vendor O also sold software to Taxpayer.

QUESTION

Are the activities set out above taxable?

¹ In its request for a ruling, Taxpayer did not refer to its vendors by name.

RULINGS

Modification and programming are taxable as sales of tangible personal property. To the extent that consulting, testing, training, and design are provided as part of the sale of tangible personal property, they are taxable. If the integration of software is necessary to, and inseparable from, the installation of tangible personal property, then it is taxable.

ANALYSIS

In Tennessee, the selling of tangible personal property at retail is a taxable privilege. TENN. CODE ANN. §§ 67-6-201(1) and 67-6-102(24)(A). “Retail sale” means “a taxable sale of tangible personal property or specifically taxable services to a consumer or to any person for any purpose other than for resale.” TENN. CODE ANN. § 67-6-102(24)(A). The term “sale” is defined to include:

[the] transfer of customized or packaged computer software, which is defined to mean information and directions loaded into a computer which dictate different functions to be performed by the computer, whether contained on tapes, discs, cards, or other device or material. For such purpose, computer software shall be considered tangible personal property...

TENN. CODE ANN. § 67-6-102(25)(B). The term “sale” also includes the fabrication or modification of computer software. Creasy Systems Consultants, Inc. v. Olsen, 716 S.W.2d 35 (Tenn. 1986) and TENN. CODE ANN. § 67-6-102(25)(A). *See also* University Computing Company v. Olsen, 677 S.W.2d 445 (Tenn. 1984) and Commerce Union Bank v. Tidwell, 538 S.W.2d 405 (Tenn. 1976).² Here, certain of Taxpayer’s vendors modify the command codes/language of the original software. The modification work performed by vendors in Tennessee is taxable as a sale of tangible personal property. Creasy. Further, some of Taxpayer’s vendors write programs or command languages to integrate software. Since programming involves the fabrication of software, it too is taxable as a sale of tangible personal property when performed in Tennessee. *Id.*

Certain services are also subject to tax, including “any services that are a part of the sale of tangible personal property...” TENN. CODE ANN § 67-6-102(26). *See also* Thomas Nelson, Inc. v. Olsen, 723 S.W.2d 621 (Tenn. 1987). Standing alone, the consulting, design, testing and training services are not subject to tax. TENN. CODE ANN § 67-6-102(24)(F). To the extent they are provided as part of the sale of tangible personal property, however, they are taxable. As noted above, modification and programming are both taxable as sales of tangible personal property. Thus, any services provided as part of either modification or programming are taxable pursuant to TENN. CODE ANN § 67-6

² Note, however, that fabrication of software by a person for such person’s own use or consumption is not a taxable use. *See* TENN. CODE ANN. § 67-6-102(25)(B).

102(26).³ Further, the facts show that vendor O sold software in addition to providing integration, design, and testing services. If O provided these services as part of the sale of software, they are taxable.

Lastly, some specifically enumerated services are subject to tax. TENN. CODE ANN. § 67-6-102(24)(F). The “installing of tangible personal property which remains tangible personal property after installation...” is a taxable as a retail sale. TENN. CODE ANN. § 67-6-102(24)(F)(vi). The facts indicate that the integration of software involves inputting data that is integral to the installation process. Mere data input is not taxable. If, however, the integration of software is necessary to, and inseparable from, the installation of tangible personal property, then it is taxable as the installation of tangible personal property. Id.

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APPROVED:

Ruth E. Johnson
Commissioner

DATE: 9-6-02

³ For example, vendor AB does both modification and design. If the design service is provided as part of the modification of software, then it is taxable pursuant to TENN. CODE ANN § 67-6-102(26).