

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 12-20**

WARNING

Revenue rulings are not binding on the Department. 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 Departmental policy.

SUBJECT

The applicability of the Tennessee sales and use tax to the sale of computer software maintenance contracts and to repair or replacement parts and/or repair labor under such contracts.

SCOPE

Revenue Rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue Rulings are advisory in nature and are not binding on the Department.

FACTS

The Vendor is located outside of Tennessee but sells computer software maintenance contracts to Customers located in Tennessee. The computer software maintenance contracts are not sold as part of a sale of computer software. Rather, these are sales consisting solely of computer software maintenance contracts. The Customer signs the contract in Tennessee; the Vendor signs the contract outside of Tennessee. The Vendor is registered for sales and use tax in Tennessee.

RULINGS

1. Does the location where the Vendor's computer software maintenance contract is made determine whether the contract is subject to the Tennessee sales tax?

Ruling: No. Whether a computer software maintenance contract is subject to the Tennessee sales tax is determined by the location of the computers on which the computer software is installed. If the Customer purchases a computer software maintenance contract that applies to software installed on computers located in Tennessee, then that contract will be subject to the Tennessee sales tax.

2. Is the sale of a computer software maintenance contract to a Customer in Tennessee subject to the Tennessee sales tax if the Vendor performs any repairs required under such contract in Tennessee?

Ruling: Yes. The sale of a computer software maintenance contract to a Tennessee Customer is subject to the Tennessee sales tax, regardless of whether the Vendor performs any repairs covered under such contract in Tennessee or outside of Tennessee.

3. Is the sale of a computer software maintenance contract to a Customer in Tennessee subject to the Tennessee sales tax if the Vendor performs any repairs required under such contract outside of Tennessee?

Ruling: Yes. The sale of a computer software maintenance contract to a Customer in Tennessee is subject to the Tennessee sales tax, regardless of whether the Vendor performs any repairs covered under such contract in Tennessee or outside of Tennessee.

4. If the Vendor does not collect Tennessee sales tax on the sale of a computer software maintenance contract to a Customer in Tennessee, will the Customer be subject to the Tennessee use tax on the contract?

Ruling: The Vendor is required by law to collect Tennessee sales or use tax on its sales of computer software maintenance contracts to Customers in Tennessee. If the Vendor fails to collect Tennessee sales or use tax on the sale of a computer software maintenance contract that pertains to software installed on computers in Tennessee, the Customer will be subject to the Tennessee use tax on the contract.

5. Will charges for and the use of repair or replacement parts and/or repair labor not covered by a computer software maintenance contract, when such repairs are performed outside of Tennessee, be subject to the Tennessee sales and use tax?

Ruling: The Vendor is not required to collect Tennessee sales tax on repair or replacement parts not covered by a computer software maintenance contract, when such parts are sold outside of Tennessee, but it is required to collect Tennessee use tax on such repair or replacement parts shipped to the Customer in Tennessee. If the Vendor fails to collect Tennessee use tax on the repair or replacement parts, the Tennessee Customer will be subject to the Tennessee use tax for repair or replacement parts. The repair labor performed outside of Tennessee will not be subject to the Tennessee sales or use tax.

6. If the Vendor does not charge a Tennessee Customer for repair or replacement parts and/or repair labor under a computer software maintenance contract, will the Customer be subject to the Tennessee use tax on such repair or replacement parts and/or repair labor?

Ruling: No. If the Vendor makes no charge for repair or replacement parts and/or repair labor under a computer software maintenance contract upon which tax has been paid, the Customer will not be subject to the Tennessee use tax on such repair or replacement parts and/or repair labor.

ANALYSIS

Under the Retailers' Sales Tax Act, TENN. CODE ANN. §§ 67-6-101 to -907 (2011), retail sales of tangible personal property and specifically enumerated items and services in Tennessee are subject to the sales and use tax.¹

In particular, TENN. CODE ANN § 67-6-231(b)(1) (2011) provides that “the retail sale of, use of, or subscription to a computer software maintenance contract shall be subject to the tax levied” under the Retailers' Sales Tax Act.² The sale of a computer software maintenance contract is taxable even if no repairs are ever performed under the contract. *See Covington Pike Toyota v. Cardwell*, 829 S.W.2d 132 (1992). TENN. CODE ANN. § 67-6-231(b)(2) provides that no additional sales and use tax shall be due “on any repairs, modifications, updates or upgrades provided pursuant to a computer software maintenance contract that is subject to tax under” TENN. CODE ANN § 67-6-231(b), unless the seller makes an additional charge for the repairs modifications, updates, or upgrades.

1. *Location where a contract is made*

Whether a computer software maintenance contract is subject to the Tennessee sales and use tax is determined by the location of the computers on which the computer software to which the contract applies is installed.

Charges for retail sales of computer software maintenance contracts that apply to software installed on computers located in Tennessee are taxable under TENN. CODE ANN. § 67-6-231(b)(1)(B). Thus, if the Customer purchases from the Vendor a computer software maintenance contract that applies to software installed on computers located in Tennessee, then that contract will be subject to the Tennessee sales tax.

¹ TENN. CODE ANN. § 67-6-102(78) (2011) defines a “retail sale” as a “sale, lease, or rental for any purpose other than for resale, sublease, or subrent.” A “sale” is defined in pertinent part as “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,” and includes “the furnishing of any of the things or services taxable” under the Tennessee sales and use tax laws. TENN. CODE ANN. § 67-6-102(80)(A)&(D). TENN. CODE ANN. § 67-6-102(91)(A) defines the term “tangible personal property” in relevant part as “personal property that can be seen, weighed, measured, felt, or touched, or that is in any other manner perceptible to the senses.”

² TENN. CODE ANN. § 67-6-102(21) defines “computer software maintenance contract” as “a contract that obligates a person to provide a customer with future updates or upgrades to computer software, support services with respect to computer software, or both.” The definition excludes “telephone or other support services that are optional and are sold separately and invoiced separately and do not include any transfer, repair or maintenance of computer software on the part of the seller.”

2-3. *Taxation of the Vendor's computer software maintenance contracts and the location where repairs under the contract are performed*

The Vendor's sale of a computer software maintenance contract that applies to software installed on a computer located in Tennessee is subject to the Tennessee sales and use tax, regardless of whether the Vendor performs repairs covered under such contract in Tennessee or outside of Tennessee.

If the repairs performed are covered by the maintenance contract, then no additional tax will be collected on such repairs. TENN. CODE ANN. § 67-6-231(b)(2). Furthermore, the sale of the contract is taxable even if no repairs are ever performed under the contract. *See Covington Pike Toyota v. Cardwell*, 829 S.W.2d 132 (1992).

4. *Non-collection of Tennessee sales tax on the sale of computer software maintenance contracts*

The Vendor is required by law to collect Tennessee sales or use tax on its sales of maintenance contracts to Customers in Tennessee. If the Vendor fails to collect Tennessee sales or use tax on the sale of a computer software maintenance contract that pertains to software installed on computers in Tennessee, the Customer will be subject to the Tennessee use tax on the contract.

In Tennessee, every dealer³ making sales of tangible personal property or taxable items or services is liable for the payment of Tennessee sales tax. TENN. CODE ANN. § 67-6-501(a) (2011); *Beare Co. v. Olsen*, 711 S.W.2d 603, 605 (Tenn. 1986). While the dealer may charge the consumer the appropriate tax, as between the dealer and the consumer, it is the dealer that is ultimately liable to the State. *Sam Carey Lumber Co. v. Sixty-One Cabinet Shop, Inc.*, 773 S.W.2d 252 (Tenn. Ct. App. 1989). Neither a dealer's failure, nor its inability, to collect the tax from its customer will relieve the dealer of this duty. *Smoky Mt. Canteen Co. v. Kitzer*, 247 S.W.2d 69 (Tenn. 1952). In the event that the dealer does not collect and remit Tennessee sales tax on the sales of taxable services or tangible personal property, it will be subject to interest and penalties. *See* TENN. CODE ANN. §§ 67-6-504(b) (2011), 67-6-517 (2011), 67-6-522 (2011). The Vendor is a dealer for Tennessee sales tax purposes. Therefore, the Vendor must collect Tennessee sales or use tax on the sale of its computer software maintenance contracts, and it will be liable to the State if it does not.

However, TENN. CODE ANN. § 67-6-231(b)(1) provides that the "retail sale of, *use of* or subscription to a computer software maintenance contract" is subject to the Tennessee sales and use tax. (Emphasis added.) Because the use of a computer software maintenance contract is specifically taxable under the statute, if the Vendor fails to collect Tennessee sales or use tax on the sale of the computer software maintenance contract as required by law, then the Customer will be liable for Tennessee use tax on its purchase of the contract.

³ A "dealer" is defined in pertinent part as every person who "furnishes any of the things or services taxable" under the Retailer's Sales Tax Act. TENN. CODE ANN. § 67-6-102(25)(H). The Vendor clearly qualifies as a dealer under this broad definition.

5. *Vendor's and Customer's tax collection/remittance responsibilities on repair parts and labor not covered under a computer software maintenance contract, when such parts and labor are sold and performed outside of Tennessee*

The Vendor is not required to collect Tennessee sales tax on repair or replacement parts not covered by a computer software maintenance contract, when such parts are sold outside of Tennessee, but it is required to collect Tennessee use tax on such repair or replacement parts. If the Vendor fails to collect Tennessee use tax on the repair or replacement parts, the Tennessee Customer will be subject to the Tennessee use tax for repair or replacement parts. The repair labor performed outside of Tennessee will not be subject to the Tennessee sales or use tax.⁴

If the repair or replacement parts sold or the repairs performed are not covered by a computer software maintenance contract, then the sale of such repairs is a sale separate from that of the contract. The retail sales of tangible personal property and certain enumerated items and services are subject to the Tennessee sales tax under the Retailer's Sales Tax Act. Specifically, charges for repairs to tangible personal property or computer software are taxable under TENN. CODE ANN. § 67-6-205(c)(4) (2011). However, only sales at retail in Tennessee are subject to the Tennessee sales tax. TENN. CODE ANN. § 67-6-202(a) (2011). Accordingly, if the sale of repair or replacement parts and repair labor occurs outside of Tennessee, then it is not subject to the Tennessee sales tax.

However, the Tennessee use tax is levied on the use of tangible personal property, computer software and certain other items. TENN. CODE ANN. §§ 67-6-203(a) & 210 (2011). Therefore, if no sales tax was collected on the sale of the repair or replacement parts, then Tennessee use tax is owed on the use of such parts in Tennessee. Because the Vendor is registered for sales and use tax in Tennessee, it is responsible for collecting the use tax on the repair and replacement parts from the Customer. But if the Vendor fails to collect the Tennessee use tax at the time of the sale, the Customer will owe Tennessee use tax on the purchase price of the parts. Note that services, including repair labor, are not subject to the Tennessee use tax.

Notwithstanding the above analysis, if the repairs performed are covered by a computer software maintenance contract *upon which tax has been paid*, then even such repairs performed in Tennessee will not be subject to further taxation. TENN. CODE ANN. § 67-6-231(b)(2) provides that “[n]o additional tax shall be due under this chapter on any repairs, modifications, updates or upgrades provided pursuant to a computer software maintenance contract” on which tax has been paid. Thus, if the repairs performed are covered by the computer software maintenance contract sold by the Vendor, then the Vendor need only collect and remit Tennessee sales and use tax on the sale of the computer software maintenance contract at the time of the sale.

6. *Tax on repairs covered under a computer software maintenance contract*

If the Vendor makes no charge for repair or replacement parts and/or repair labor under a computer software maintenance contract upon which tax has been paid, the Customer will not be subject to the Tennessee use tax on such repair or replacement parts and/or repair labor.

⁴ Note that the tax consequences discussed in this analysis would also apply to parts and labor that are covered by a computer software maintenance contract, if no Tennessee sales or use tax was paid on the sale or use of such contract.

As discussed in the analysis to Ruling #2-3, when a Vendor sells a computer software maintenance contract to a Customer, the taxable event is the sale of the contract, not any repairs performed subsequently under the contract. TENN. CODE ANN. § 67-6-231(b)(2) provides that no additional tax is due on any repairs to the extent they are covered by the computer software maintenance contract, including use tax.

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