



This Week in State Tax (TWIST)

June 1, 2026



Tennessee: Appellate court says sales of software not subject to business tax, but certain services are

In a recently published decision, the Tennessee Court of Appeals analyzed whether the taxpayer, a seller of enterprise software and various related support services, was subject to the Tennessee business tax for its sales to Tennessee customers. The business tax is a gross receipts tax imposed on businesses engaged in certain types of business activities in the state, with various classifications used to determine the applicable tax rate.

Following an audit, the Tennessee Department of Revenue assessed business tax on the taxpayer's receipts from the licensing of software (both on-premise and remotely accessed), subscriptions for infrastructure-as-a-service ("cloud hosting"), and various other cloud-based services such as support, configuration, training and consulting. The Department identified all of these activities as being taxable services under the Business Tax Act. The taxpayer filed a complaint with the Chancery Court which ruled that the licensing of software was not subject to the business tax because it constituted sales of nontaxable intangible property and further held that cloud hosted offerings were not subject to business tax as the sales were akin to leasing property outside of Tennessee. However, the court upheld the assessment on certain cloud-based services, finding that those services were delivered to Tennessee customers.

On appeal, the Court of Appeals agreed with the trial court that the sale of the taxpayer's software represents the sale of intangible property. The appellate court relied on a previous Tennessee Supreme Court decision which held, for sales tax purposes, that the sale of software involves the sale of information, and that any tangible medium used in the exchange is merely incidental to the intangible property. Although the Tennessee legislature later enacted provisions expressly defining computer software to be subject to sales and use tax regardless of the nature of delivery, the previous Supreme Court's decision did not involve business tax, and the legislature has not enacted similar changes under the Business Tax Act.

With respect to the taxpayer's sales of cloud hosting, the appellate court disagreed with the trial court, finding that the "true object" of the transaction is access to the taxpayer's computing infrastructure and functionalities. The trial court had considered cloud hosting to be tantamount to the leasing of tangible personal property, but the appellate court consulted dictionary definitions to determine that leasing involves the conveyance of possession and control of tangible personal property. Here, there was no evidence that any hardware or server equipment was ever physically delivered to customers. Instead, by granting access to infrastructure, the taxpayer was engaged in an activity or work for profit, which made the activity a service for purposes of the business tax.

Finally, the appellate court reviewed how the taxpayer's cloud-based services should be sourced for purposes of

Learn about us:



[kpmg.com](https://www.kpmg.com)

INTERNAL USE ONLY

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. USCS039001

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.



This Week in State Tax (TWIST)

June 1, 2026



the business tax. The taxpayer argued that these services were not delivered in Tennessee because nothing was physically delivered to a location in Tennessee and because none of its employees ever traveled to Tennessee to perform any services. The appellate court again consulted dictionary definitions to determine that the meaning of “delivery” includes services where electronic access is provided to someone. Because the taxpayer’s customers electronically accessed the cloud-based services from their locations in Tennessee, the services were “delivered” in Tennessee and therefore subject to the business tax. The appellate court also agreed with the Department that the use of “ship-to” addresses was a reasonable method for determining where the services were delivered.

For any questions regarding [SAP America, Inc. v. Gerregano](#) or the Tennessee Business Tax in general, please reach out to [Justin Stringfield](#) and [Chris Geer](#).

Learn about us:



[kpmg.com](https://www.kpmg.com)

INTERNAL USE ONLY

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. USCS039001

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.