



Tax Insights
from State and Local Tax
Services

Tennessee Court of Appeals finds software licenses exempt from business tax; cloud-based hosting and services taxable

June 16, 2026

In brief

What happened?

The Tennessee Court of Appeals on May 13, 2026 held that receipts from computer software licenses are exempt from Tennessee business tax as sales of intangible personal property. The court found that cloud hosting and related cloud-based services are taxable when electronically delivered to Tennessee locations.

[SAP America, Inc. v. David Gerregano, Commissioner of Revenue, State of Tennessee, No. M2024-01399-COA-R3-CV, Tenn. Ct. App. \(5/13/26\)](#)

Why is it relevant?

For out-of-state service providers, the decision emphasizes that Tennessee business tax exposure is dependent on the customer's delivery or access location rather than the provider's performance location. Electronic access by Tennessee users establishes in-state delivery, making customer, billing, "ship-to," and service-location data important support for sourcing positions. It also highlights that prewritten computer software is considered intangible personal property for purposes of the business tax, despite being defined as tangible personal property under the sales and use tax statutes.

Actions to consider

Companies selling software, SaaS, or cloud-based services, as well as other companies filing business tax, franchise and excise tax, or sales and use tax returns, may want to consider the following:

- Review Tennessee business tax positions for software, SaaS, cloud hosting, cloud-based services, and sales of other items that might be classified as sales of intangible property or leases of property.
- Revisit contract terms, product mapping, and invoicing practices.
- Prepare for potential vendor pricing, invoicing, or tax collection changes.
- Assess whether procurement, accounts payable, or other in-house data is “clear and cogent” evidence reflecting where services are received or accessed.
- Assess whether refunds may be available to the extent tax was remitted historically on the sale or license of software.
- Consider potential implications of the court declining to apply sales and use tax legislative action to business tax (i.e., business tax inaction as proof of legislative intent).
- Consider potential implications of the court looking to the common meaning of undefined terms (e.g., “delivered”) versus looking to other bodies of Tennessee law or other federal or state law.
- Consider potential implications of the court declining, due to an absence of specific statutory language, to reference the SIC Index as dispositive of whether a gross receipt is generated from a sale of tangible property, intangible property, or services.

In detail

Background

The taxpayer licenses enterprise resource planning software through on-premise downloads and remotely accessed SaaS, and also provides customer-specific software, maintenance, cloud hosting, and cloud-based services, such as support, configuration, training, consulting, data conversion, and migration.

Following an audit for 2014–2018, the Tennessee Department of Revenue assessed business tax, interest, and penalties on receipts from software licensing, cloud hosting, and cloud-based services. The Department classified all of these activities as sales of services under Classification #3. The taxpayer challenged the assessment, arguing that software receipts were sales of intangible property not subject to the tax and did not constitute taxable services; cloud hosting was a nontaxable lease of tangible or intangible property located outside Tennessee; and cloud-based services were not subject to business tax because nothing was physically delivered to a location in Tennessee, no SAP employees traveled to Tennessee to perform the services, and all services were provided remotely from locations outside Tennessee.

The chancery court agreed that software receipts and cloud hosting receipts were not subject to tax, but cloud-based services were subject to tax and taxable. The Department appealed.

Software licenses treated as intangible personal property

The Court of Appeals affirmed that receipts from software licenses, including on-premise software, remotely accessed software (SaaS), and customer-specific on-premise software, are sales of intangible personal property not subject to Tennessee business tax. The court noted that although Tennessee's sales and use tax statutes were amended to treat prewritten computer software as tangible personal property, no corresponding amendment was made to the Business Tax Act. The court placed continued reliance on the Tennessee Supreme Court's holding in *Commerce Union Bank v. Tidwell*, 538 S.W.2d 405 (Tenn. 1976) that computer software constitutes intangible personal property for purposes of the business tax.

The court also rejected the Department's reliance on SIC Index classifications treating software sales as services, concluding that those classifications are referenced solely for determining whether the Classification 3(C) exemptions apply and were not relevant to determine whether software constitutes intangible personal property for business tax purposes. The holding also extended to software maintenance, including updates, patches, and fixes.

Cloud hosting treated as a taxable service

The court reversed the chancery court's ruling that cloud hosting was a nontaxable lease of out-of-state hardware. Given customers did not receive certain property rights typically associated with a lease of property (e.g., possession or control of the property--here, taxpayer's servers, hardware, or software platform), the court rejected the taxpayer's proposed lease characterization. Applying the true object test, the court found that cloud hosting provided customers access to vendor-managed infrastructure and constituted a taxable service as an "activity, function, or work engaged in for profit or monetary gain."

Cloud-based services delivered electronically to Tennessee

The court affirmed that cloud-based services, including support, configuration, training, consulting, conversion, and migration services, were taxable when delivered to Tennessee locations. The court held that the 2016 statutory amendment shifted the test for out-of-state service providers from where services are performed to where they are delivered, and that delivery was completed, based on the common meaning of the term "delivered," when the customers electronically accessed the services from their location in Tennessee. The court also upheld the Department's reliance on invoice "ship-to" addresses to establish delivery location because the taxpayer did not offer "clear and cogent" alternative data to prove the Department's method was inaccurate.

The court vacated the trial court's award of attorney fees and remanded to the trial court to enter summary judgment on cloud hosting.

Let's talk

For more information on the impact of this decision, please contact:

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