On Cloud 9: Almost 10 Use Cases of Cloud Taxation
Use Case # 1

Company sells electronically delivered software to customers
Is electronically delivered software subject to sales and use tax?

A. Yes, but only in roughly 10% of states
B. Yes, but in less than half of states
C. Yes, in more than half of states
D. No
Electronically Delivered Software

• Software delivered electronically is taxed in more than half the states.

• For example, states that tax electronically delivered software include:
  ▪ Massachusetts
  ▪ Texas
  ▪ New Jersey
  ▪ Kentucky

• For example, states that *do not* tax electronically delivered software include:
  ▪ California
  ▪ Florida
  ▪ Virginia
  ▪ Maryland
Electronically-Delivered Prewritten Computer Software

Taxable
Use Case # 2
Company sells remotely accessed software to customers
Is remotely accessed software subject to sales and use tax?

A. Generally yes, as Tangible Personal Property
B. Generally yes, as a taxable service
C. Generally no
Remote Access Software

• Providing customer’s access to software hosted on remote servers is generally referred to as “remote access software.”
• Generally, there is no download of software if the software is accessed remotely.
• Customers are only given some limited rights or access to the software.
• There may also not be a full license to the software.
Remote Access Software

• Thus, some states tax remote access software differently than electronically delivered software.

• Some states have concluded that there is no transfer (e.g., download) of tangible personal property.

• These states do not impose sales tax on remote access software because it is neither the transfer of TPP nor an enumerated service.
  - New Jersey, Oklahoma, Colorado

• Other states expressly exempt remote access software
  - Rhode Island
Remote Access Software

- Other states do not recognize this distinction and statutorily impose sales tax on remote access software:
  - For example, Washington law provides that “Sales of remote access prewritten software on the seller's (or a third-party's) servers are subject to retail sales tax.”

- Other states tax remote access software as a taxable service
  - Information service
  - Data processing service – TX, OH
  - Computer-related services – CT
  - Communication service – SC
  - Some states impose tax on remote access software if the software resides on a server in the state –
    - Utah and Kansas
Remote Access Pre-Written Computer Software
Use Case # 3

Company sells electronically delivered software to customers and also provides consulting and other related services with the software.
Is the purchase of electronically delivered software and related services subject to sales and use tax?

A. Yes, as software
B. No, because the services are not software
C. Depends
D. I have no idea, but when is dessert
Software and Services

- The taxability of the sale of software and related consulting, maintenance or other services may depend on several factors:
  - Whether the services are independently taxable;
  - Whether the services are separately billed and stated from the software charges;
  - Whether the services can be purchased independently and separately from the software;
  - Whether the services are deminimis; and
  - Whether the true object of purchase is the software.
Software and Services

• The Minnesota Tax Court held that computer software consulting and implementation services provided with the sale of ERP software were not subject to sales tax. *SAP Retail, Inc. v. Comm’r of Revenue*, No. 8345-R (Minn. Tax Ct. Sept. 19, 2013)

  ▪ The services were not specifically enumerated as taxable services.
  ▪ The services did not constitute taxable fabrication services because the consumers of the services did not furnish materials used to create the software.
  ▪ The services were not part of the taxable software license fee because (1) they were provided pursuant to a separate agreement and, even if sold as a package, were separately itemized, and (2) the services were not necessary to complete the sale of a software license that could be purchased without the services and vice versa.
Software and Services

- The Commission determined that receipts derived from the renewal of annual software maintenance contracts are not subject to sales tax when no physical media is supplied and software updates are available for download via the Internet. Ok. LR-13-034 (Sept. 23, 2013)

  - By statute, Oklahoma law exempts from sales tax prewritten software delivered to a customer electronically. Oklahoma’s regulations provide that this exemption includes optional software maintenance contracts under which prewritten upgrades are delivered to customers by means other than tangible storage media.
Use Case # 4
Company sells electronic information or database services to customers that utilizes a software based platform
Is an electronic information service utilizing a software based platform subject to sales and use tax?

A. Yes, as a taxable information service
B. Yes, as a taxable data processing service
C. Yes, as computer software
D. Generally, no
Software Based Platforms

• States vary in their treatment of electronic information services utilizing software based platforms

• Some states treat this as “data processing services”
  - Texas, for example, includes computerized data processing and information storage from the cloud in data processing, but exempts the first twenty percent of a charge from tax.

• Other states that may not tax remote access software may still tax certain “information services”
  - New Jersey, for example, taxes “information services” which is defined as “the furnishing of information of any kind, which has been collected, compiled, or analyzed by the seller, and provided through any means or method, other than personal or individual information which is not incorporated into reports furnished to other people.”
Software Based Platforms

• Many states have attempted to tax such services because they involve software.
  - For example, in New York sales of a product that provides users single sign-on access to electronic research and data from multiple sources are subject to sales and use tax because the product, in aggregating the information, is a taxable information service. N.Y. Advisory Opinion, TSB-A-14(3)S (Jan. 27, 2014)
Software Based Platforms

• In Indiana, the DOR concluded that Internet-based information platforms and computer software maintained on servers outside the state, but accessed via the Internet may be taxable transfers of prewritten software. Indiana Letter of Finding 04-20130306 (Feb. 12, 2014)

  ▪ Access of prewritten software, even if via the cloud, constitutes a taxable transfer of software because customers gain “constructive possession and the right to use, control, or direct the use of the software.”
Software Based Platforms

• Other states concluded that such services are not taxable:
  - For example, the Michigan Court of Appeals held that Checkpoint, an online tax and accounting research program under a subscription based model, was not taxable. *Thomas Reuters, Inc. v. Department of Treasury* (Mich. 2014).
  - Michigan adopts the “incident to service test” which “looks objectively at the entire transaction to determine whether the transaction is principally a transfer of tangible personal property or a provision of a service.”
  - In this case, the court held that any transfer of TPP (software) was incidental to the service provided by Checkpoint.
  - Because customers primarily sought access to up-to-date information relevant to their needs—a nontaxable information service—they did not primarily seek physical software, and thus the transaction was not taxable.
Software Based Platforms

• Subscription to online merchandise database is not subject to sales and use tax whether or not bundled with additional support or services. Massachusetts Letter Ruling LR 14-1 (Feb. 10, 2014)
  ▪ True object of the transaction is the provision of access to the information, which constitutes a nontaxable “database service.”
  ▪ Not the taxable "sale, license, lease or other transfer of a right to use software on a server hosted by the taxpayer or a third party.”
Use Case # 5
Company sells computing power to customers that utilizes a software based platform and requires software to utilize
Is the sale of computing power that utilizes a software-based platform and requires software to utilize subject to sales and use tax?

A. Yes, as Platform as a Service
B. Yes, as Infrastructure as a Service
C. Yes, as computer software

33% 33% 33%
Cloud Computing With Software

• This service could be characterized as a PaaS or IaaS service.
• The PaaS model allows the consumer to run consumer-created or acquired applications on the cloud provider’s platform.
• The consumer does not manage or control the underlying cloud infrastructure including network, servers, operating systems, or storage, but has control over the deployed applications and possibly the application hosting environment configurations.
• An example of a PaaS model includes web hosting and managed services.
Cloud Computing with Software

• The IaaS model provides the consumer with processing, storage, network capabilities, and other fundamental computing resources where the consumer is able to deploy and run software, which can include operating systems and applications.

• The consumer does not manage or control the underlying cloud infrastructure but has control over operating systems, storage, deployed applications, and possibly limited control of select networking components (e.g., host firewall).

• Commonly includes provision of various service components that are commonly subject to sales/use tax, including but not limited to:
  - Hardware maintenance, software maintenance, repair labor, security services, electricity.
Cloud Computing with Software

• The Division of Taxation issued a technical bulletin that confirmed the state does not tax sales of cloud computing services including SaaS, PaaS, and IaaS. New Jersey Division of Taxation Technical Bulletin TB-72 (July 3, 2013)

• The Division explained:
  - SaaS retailers provide customers with access to software through remote means;
  - PaaS retailers provide customers with computing platforms through remote means; and
  - IaaS retailers provide customers with equipment and services necessary to support and manage the customer’s content and dataflow through remote means.
Cloud Computing with Software

- The Division stated that SaaS, PaaS, and IaaS do not fit within the definition of tangible personal property (which includes “computer software”) because the retailer does not transfer any software to its customers.

- Further, New Jersey does not enumerate SaaS, PaaS, or IaaS as taxable services.
Cloud Computing with Software

• The TN DOR determined that a taxpayer’s sale of remote storage services and virtual computing services are not subject to sales or use tax where the data centers and servers used to provide such services are located outside the state. Tennessee Letter Ruling 13-12 (Sept. 12, 2013)

  The DOR determined neither service was subject to Tennessee sales and use tax because there was no sale, transfer or electronic delivery of tangible personal property or computer software in Tennessee in connection with the furnishing of these services.
Cloud Computing with Software

- Massachusetts determined that a subscription to an online database that allowed purchasers and suppliers of various goods to access a database containing shipping information was not subject to sales and use tax because the “object of the transaction” was nontaxable data processing. Massachusetts Letter Ruling LR 14-1 (Feb. 10, 2014).
  - While the taxpayer’s customers execute an agreement to access the website, the customers never download any software.
  - Under Massachusetts law, the sale or other transfer of a right to use software on a server hosted by the taxpayer or a third party is subject to sales or use tax. However, where there is no separate charge for the software, and the object of the transaction is acquiring a good or service other than the software, Massachusetts sales or use tax generally does not apply.
  - The true object of the transaction was the provision of access to information, which constituted a nontaxable database services.
  - The Department held that it was not the taxable “sale, license, lease, or other transfer of a right to use software on a server hosted by the taxpayer or a third party.”
Cloud Computing With Software

• Other States have enacted legislation that specifically exempts cloud computing services
  
  ▪ Idaho
  
    ▪ Provides that taxable tangible personal property does not include application software accessed over the Internet or through wireless media
    
    ▪ Application software does not include remotely-accessed software for entertainment purposes or if the vendor offers the same software for sale in a storage media or as a download
  
  ▪ Utah
  
    ▪ Establishes a new sales and use tax exemption for amounts charged to access a database if the primary purpose for accessing the database is to view or retrieve information from the database
Use Case # 6

Company sells a video game subscription that is accessible via the Internet or a Cloud Network and does not require any download of software.
Is the sale of an online video game subscription that does not require any download of software subject to sales and use tax?

A. No, subscription fees are not taxable
B. No, because no software is downloaded
C. Possibly
D. Not sure
Video Games

- Video games have received mixed treatment in many states.
- Some states characterize video games as software.
- Some states characterize video games as digital goods.
- The characterization and taxability becomes more complicated when there is no download.
Video Games

- The Department found that remote access to gaming software and virtual goods is not subject to tax, but the same content downloaded should be treated as downloaded prewritten software. Kansas Private Letter Ruling P-2011-004 (June 16, 2011)
  - This decision was based on the statutory scheme which provides that downloaded prewritten computer software is subject to tax but remote access software is not
Video Games

- The Missouri Department of Revenue found that remote access to software and virtual content was not taxable. Missouri Private Letter Ruling No. LR 6866 (Aug. 18, 2011)
  - This decision was based on the fact that in Missouri, only software delivered on tangible media is subject to tax
  - Missouri approached taxation of downloaded content by looking back at the original gaming software purchase to determine taxability of the downloaded content. Missouri concluded that the determinant in whether the downloaded gaming content is taxable is the method of delivery of the base gaming software
  - In other words, the vendor must know at the time of the sale of downloaded content whether the original game was purchased on tangible medium or by download
Video Games

• The TN DOR determined that the sale of access codes for remotely accessed online games and virtual goods is not subject to Tennessee sales and use tax. However, the sale of access codes for downloadable video games, add-on packs and play levels is subject to Tennessee sales and use tax. Tennessee Letter Ruling 13-15 (Oct. 14, 2013)

  The DOR concluded that there was no sale of tangible personal property, including prewritten software, when the online games are accessed remotely on servers outside of Tennessee. In addition, there is no download to the customers computer. Finally, the DOR noted that there is no provision of a taxable service.
Video Games

- The DOR concluded that video games and add-on packs fit within the definition of computer software. Because the sale of the access codes for downloadable games allow the customer to download software, the access codes are subject to sales and use tax. It is irrelevant that the customer is buying the access codes or the actual games.

- Lastly, the DOR addressed the sale of notional value or points card. The DOR concluded that the sale of such cards is not subject to sales and use tax because the true object of the cards is the intangible right to purchase game items. However, when the cards are redeemed the purchased item may be taxable.
Use Case # 7
Company sells voice, data and other similar telecommunication services via a cloud network
Is the sale of voice, data and other similar telecommunications services via a cloud network subject to sales and use tax?

A. No, if its delivered via the Cloud
B. Yes, telecommunication services are always taxable
C. Depends
Telecommunication Services

- All states and most local governments impose taxes and/or fees on the sales of telecommunications services, whether on the charges or gross receipts, or on a per line or access basis, to varying degrees.
- Many states define “telecommunication services” or “communications services” in a broad manner for tax purposes, typically more expansive than under their regulatory regimes.
Telecommunication Services

- State and local tax and regulatory laws have not kept pace, with emerging technology
- As a result, some state laws may not tax telecommunications services provided via nontraditional communication infrastructure and/or lines
Telecommunication Services

• The Missouri DOR determined that a company’s telecommunications services provided to customers on its cloud computer network are subject to sales tax. L.R. 7248, Mo. Dept. of Rev. (May 24, 2013)

• The company hosted its cloud network on servers located outside of MO, and customers accessed the network through public telecommunications lines and through the customers’ internal network; customers separately purchased the necessary hardware and Internet access

• Services provided to customers through the cloud network include voice, video, messaging, and conferencing
Telecommunication Services

- The DOR determined that the company is providing taxable “telecommunication services” because it transmits information through its services that direct and control its customers’ hardware and because it stores messages on its server, which are taxable events in Missouri.

- The DOR also noted that customers would not be able to use their equipment without the company’s software and hosting unless the customer was willing to engage another telecommunications company or built its own in-house system.
Use Case No. 8

Company sells streaming video subscriptions that are accessible via the Internet or a Cloud Network
Are streaming video subscriptions accessible via the Internet or a Cloud Network subject to sales and use tax?

A. No, because there is no download
B. No, because subscriptions are not taxable in most states
C. Possibly
Streaming Video Subscriptions

• State and local tax and regulatory laws have not kept pace, with emerging technology in the delivery of videos resulting in uncertainty in the applicability of taxes and fees and lack of parity among competing providers.

• As a result, several states have recently reformed their tax and regulatory regimes.
Streaming Video Subscriptions

• Why does characterization matter? Taxability and Sourcing
• What are you selling/buying?
  ▪ Telecom Service
  ▪ Digital Good or Service
  ▪ Software
  ▪ Data Processing or Information Service
  ▪ Tangible personal property
  ▪ Something else?
Streaming Video Subscriptions

  - The sale or rental of streaming video content is not subject to Missouri sales or use tax
  - The service in question allowed customers to purchase or rent video content and to stream the content through devices like computers and televisions via the Internet
    - Analogizing the service to prewritten computer software—which is not taxable when delivered in any medium other than TPP—the Department found that streaming content is likewise not taxable because no TPP is transferred
Streaming Video Subscriptions

- Texas adopted regulatory amendments redefining the scope of taxable cable television services. 34 Texas Admin. Cd § 3.313
  - The revised regulation defines for the first time several terms related to the cable television services industry; adopts a destination-based sourcing rule for intrastate sales of streaming video; and taxes “bundled cable services.”
  - The Comptroller defines a “cable system” as the “system through which a cable service provider delivers cable television or bundled cable service” and states that it may comprise “any or all of the following: tangible personal property; real property; and other media, such as radio waves, microwaves, or any other means of conveyance now in existence or that may be developed.” Texas’s regulatory definition of “cable system” now exceeds the scope of the term as defined by the FCC
  - The amended regulation also revised the definition of “cable television service” to encompass all forms of video programming, including streaming video, whether provided via the Internet or other technology
Streaming Video Subscription

• State and local jurisdictions have issued assessments to streaming video providers based on varying theories, of which most were not made public by ruling or regulation prior to the audit.

• Netflix is the lead taxpayer in several of the pending controversies, including:
  - Kentucky – Telecom Taxes
  - St. Charles Parish (Louisiana) – Local Sales Tax
  - City of Chicago – Lease Tax
Use Case # 9
Company sells data and content storage space that is accessible via a Cloud Network
Is the sale of storage space that is accessible via a Cloud Network subject to sales and use tax?

A. Yes, because renting storage space is taxable even if in the Cloud
B. No, because its virtual storage space
C. Not sure
Storage Space Via the Cloud

• The taxability of data, document and content storage likely depends on whether any software is required to utilize the service
• It may also depend on whether the service provider is providing any content or other information with the service
• Finally, states may consider the true-object of the service.
Storage Space Via the Cloud

• The TN DOR determined that a taxpayer’s sale of remote storage services are not subject to sales or use tax where the data centers and servers used to provide such services are located outside the state. Tennessee Letter Ruling 13-12 (Sept. 12, 2013)
  - The DOR determined the service was subject to Tennessee sales and use tax because there was no sale, transfer or electronic delivery of tangible personal property or computer software in Tennessee in connection with the furnishing of these services
  - The DOR noted that the taxpayer prohibited customers from downloading any part of its remote storage interface or its virtual computing software
Storage Space Via the Cloud

• The DOR determined that the primary purpose of the remote storage service was the remote storage of digital data, applications and information
Questions?

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