Cloud Computing – Is the Sky Clearing?
Overview

• More states have started to issue administrative guidance (i.e., rulings) addressing the taxability of cloud computing services.
• Approximately 10 states have issued rulings, bulletins or other administrative guidance.
• Rulings are pending in several other states.
• Some states have addressed the taxability of cloud computing services through recent updates to regulations (e.g., VT).
• Courts in some states have issued decisions addressing software and services (e.g., MI).
• We expect that there will be continued activity in this area in upcoming state legislative sessions.
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

AK  OR  CA  NV  MT  WY  CO  ND  SD  NE  IA  KS  MO  IL  IN  OH  MI  WI  MN  IA  IL  IN  OH  MI  WV  PA  NY  CT  VT  MA  RI  DC  MD  WV  VA  NC  SC  GA  FL  AL  MS  TN  AR  OK  MO  OK  AR  TX  LA  NM  AZ  ID  UT  WA  OR  AK
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 no 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
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.
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.”
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
• An example of a PaaS model includes web hosting and managed services
• 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
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 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

• In Georgia Letter Ruling SUT 2014-02-20-01, February 20, 2014 the Department concluded that remote access to software is not subject to tax.
  
  ▪ Because Georgia does not tax computer software delivered in a non-tangible medium, software made available to a consumer remotely is not taxable as tangible personal property. The software would only be taxable if it fell within an enumerated taxable service.
  
  ▪ The Department held that the cloud computing services were not subject to sales and use tax because cloud subscription services are not among the enumerated taxable services.
Cloud Computing with Software

In South Carolina Private Letter Ruling 14-2, August 26, 2014, usage fees charged for uploading, downloading, or moving data were concluded not subject to tax on communication services.

- Taxpayer provided computing capacity and storage services to users. The taxpayer's service allowed customers to store and retrieve large amounts of data at any time and from any location through the internet, by setting up an account that enables them to upload and download their content to and from servers located outside of South Carolina.

- The Department held these services not taxable because there was no sale of tangible personal property, and not to the sales tax on communication services because they were not charges for the manner, method, or instrument for sending a signal of the voice or of messages.
Cloud Computing with Software

• In Virginia Document 14-42, March 20, 2014 the Department concluded that cloud computing is not subject to tax.
  - Generally, cloud computing services are treated in the same manner as the electronic transfer of software products.
  - There is typically no transfer or provision to customers of cloud computing services via a tangible medium.
  - Because software is only taxable when delivered in a tangible medium, transactions for cloud computing services are an exempt service and are not subject to the retail sales and use tax.
Cloud Computing with Software

• In Wyoming Bulletin: Computer Sales and Services, July 1, 2014, the Department provided that the three main service models in cloud computing -- software as a service, platform as a service, and infrastructure as a service -- are not subject to tax.
  - As the models rely on an external hosted site, neither is subject to sales tax unless the customer receives tangible personal property or an enumerated service embedded within the service.
  - Generally, these types of services involve a monthly or annual fee in order to gain access to the web hosted site where information is made available. The fee is not subject to sales tax when the web hosted site maintains control over the housed information.
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
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

  - 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
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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