STATE OF COLORADO

DEPARTMENT OF REVENUE
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PLR-13-006

September 18, 2013

XXXXXXXXXXXXXX
ATTN: XXXXXXXXX
XXXXXXXXXXXXXX
XXXXXXXXXXXXXX

Re: Private Letter Ruling

Dear XXXXXXXXXX,

You submitted on behalf of XXXXXXXXXXXXXX ("Company") a request for a private letter ruling to the Colorado Department of Revenue ("Department") pursuant to Regulation 24-35-103.5. This letter is the Department's private letter ruling.

Issues

1. Is the hardware and software that Company purchases, leases or licenses from third-parties purchased, leased or licensed for use or consumption by Company and not for resale subject to sales or use tax?
2. Are the services provided through the cloud-based service offerings non-taxable services or a lease or license of hardware and software?
3. If cloud-based service offerings constitute a lease, license or other transfer of software to a client, are such transfers exempt from tax as electronically delivered software?
4. Are the services provided through the cloud-based service offerings non-taxable telecommunications services?
5. For sales and use tax purposes, where are the services through the cloud-based service offerings provided?

Conclusion

1. The hardware and software purchased by Company is consumed by Company in the provisioning of services to clients and is not resold to clients.
2. The services provided through cloud-based service offerings are services and are not a lease or license of hardware and software to clients.
3. The cloud-base service offerings are not leases, licenses, or other transfers of software to clients.
4. Company's charges are intrastate telecommunications services when provided to clients located in Colorado and are subject to state and state-administered local sales taxes.
5. Company is providing intrastate telecommunication services in Colorado.

Background

Company is a technology solutions provider that offers a multitude of advanced technology solutions. Its products range from discrete hardware and software products to complex technology solutions such as virtualization, collaboration, security, mobility, data center optimization and cloud computing. Company is interested in the applicability of Colorado sales and use taxes on cloud-based service offerings that provide cloud-based applications and related services ("Cloud Collaboration Services") that support a client's telecommunication needs.

Through Company's cloud-based service offerings, Company will replace and provide clients with Company-hosted hardware and software needed to direct client's telecommunications equipment to route and process calls internally. Although clients already have a telecommunications provider that provides telephone lines to make outgoing and receive incoming calls, clients need certain hardware and software that instruct their telecommunications equipment to process and route those calls within the business. This process has generally been handled internally by the client and such functions have not been subject to tax. Company provides this service to its clients from an offsite location outside of Colorado.

More specifically, Company operates back-office equipment and software applications to provide necessary or enhanced functionality to a client's phone systems and other telecommunication devices, but the client still provides the telecommunication equipment. This process is provided on a remote basis through the use of Company-owned Cisco Unified Communications Manager ("Call Control") clusters located at a Company data center. These Call Control clusters will arrange a variety of available Company-owned software applications that are utilized through client-owned phones and workstations at client's place of business. Clients are responsible for providing connectivity of sufficient bandwidth between the client's location and Company's data center. Company also relies on the client's QoS-enabled voice-grade Local Area Network and Wide Area Network to provide this service throughout the client's geographic location. All connections between the client and Company's data center are through a client's existing public switched telephone circuits, Internet or network connection, for which the client already pays their telecommunication provider. A brief description of the supporting services provided by Company-owned applications is as follows:

- *Voice*. A Company server, utilizing the Call Control, communicates with the client's switch to provide instructions as to how to process and route incoming and outgoing calls among the client's phone extensions; the call is not routed through Company's servers. The Call Control system also supports a client's other forms of communication to its IP endpoints, media- processing devices, VoIP gateways, mobile devices, and multimedia applications.
- *Video*. The video support services will be provided by Company's server through a Call Control cluster in the same manner as outlined in Voice, above, with respect to a client's voice communication capabilities.
- *Messaging*. When a client's phone extension does not answer an incoming call, the Company server, utilizing the Call Control, will instruct the client's switch to send the

call to voicemail. The voice messages are then stored on Company's servers and available for the user to access and manage at his or her convenience. The voice-messaging support services provided by the cloud-based service offerings will allow users to access and manage voice messages stored on Company-owned servers in a variety of ways, using an email inbox, web browser, Smartphone, and other components.

- *Presence*. Presence support services are provided by Company through a Cisco Unified Presence ("Instant Messaging") application that provides users the ability to determine when colleagues are available. The Instant Messaging application offers the flexibility of rich, open interfaces that allow enablement of instant messaging and rich, network-based presence for a wide variety of business applications. The client's own communication equipment accesses the Instant Messaging application hosted on Company's servers.
- *Audio Conferencing*. Company supports a client-owned router and the phone devices through its hosted Call Control in a manner similar to that described in Voice, above.
- *Web Conferencing*. Cisco's WebEx ("Web Conferencing") application is an optional, subscription-based component. Web Conferencing is a cloud-based web conferencing application that permits desktop sharing through a web browser with phone conferencing and video. Web Conferencing operates through a user's computer or wireless device, and audio connection (either through a computer or phone), and a webcam (optional).
- *Mobility Services.* Mobile clients can place and receive calls over their own corporate wireless local area network and telephony infrastructure using Company's server to instruct the routing of calls and essentially turn a mobile phone into another extension of the Call Control. Company server, itself, does not provide the routing for the call or otherwise function as a switch.

Company's clients are always the "customer of record" for the transmission or transportation of messages or information; Company's applications do not transmit or transport messages or information. In addition, all client communication with third parties are through client-contracted public switched telephone network connections and not through Company and are never physically routed through Company's data center equipment.

Company acquires, owns (or is the lessee or licensee of), operates and maintains the Company-hosted hardware and software necessary to provide this service. The hardware and software required to provide this process are installed on servers located outside of Colorado. Company employees based at this location outside of Colorado will provide onsite professional services to maintain the hardware and software, and employees based at another location, also outside of Colorado, will remotely monitor performance, provide troubleshooting for issues that arise during performance and perform necessary adds, moves, changes and deletions. However, Company may also host and deploy certain client-owned software applications utilized in the same manner as Company-hosted software applications as an add-on service for additional fees.

To purchase the cloud-based service offerings, clients enter into a contract with Company that include a customer service order, service description, and detailed pricing invoice.

Based on the contract, Company charges the client a monthly user license fee calculated based on the number of users. The monthly fee covers the charges for hardware, software, virtual server instance, required storage, rack space, power and cooling, monitoring and management, most moves-adds-changes, and major version upgrade charges. To the extent a client purchases add-on services, separate fees are charged for each service. Charges for maintenance and management of any client-owned software applications are also separately stated on the monthly invoice.

Discussion

Hardware and software purchased, leased, or licensed by Company from third parties are used and consumed by Company to provide services to clients and are not sold, leased, or otherwise transferred by Company to clients. [1]

Colorado levies sales and use tax on the sale, use, storage, or consumption of tangible personal property but generally not on the provisioning of services. A sale includes a lease or license to use tangible personal property.[2] The fundamental question presented in this request for ruling is whether Company is leasing tangible personal property to its clients or whether Company is the consumer of the property as the means by which it provides a service. There are two types of property at issue here: computer software and computer hardware. We first address computer software.

Computer Software

Colorado statutes define tangible personal property to include software but only if it meets certain conditions. Among those conditions is the requirement that the computer software be delivered in a tangible medium. Computer software provided by an application service provider ("ASP") is not subject to tax because subsection 39-26-102(15)(c)(I)(C), C.R.S. expressly states that such software is not delivered in a tangible medium.

> (C) The computer software must be delivered to the customer in a tangible medium. Computer software is not delivered to the customer in a tangible medium if it is provided by an application service provider, ...

Subsection 39-26-102(15)(c)(II)(A), C.R.S. defines an ASP.

> "Application service provider" or "ASP" means an entity that retains custody over or hosts computer software for use by third parties. Users of the computer software hosted by an ASP typically will access the computer software via the internet. The ASP may or may not own or license the computer software, but generally will own and maintain hardware and networking equipment required for the user to access the computer software. Where the ASP owns the computer software, the ASP may charge the user a license fee for the computer software or a fee for maintaining the computer software or hardware used by its customer.

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[1] Issues No. 1, 2 and 3, as set forth in the request for ruling, are resolved in this section. Because we find Company is providing a service, we have thereby determined that there is no transfer of software by Company (Issue 2), which, in turn, renders moot whether any such transfer is exempt (Issue 3).

[2] §39-26-102(23), C.R.S.

Company owns the software applications that provide the Cloud Collaboration Services. Data is sent from client-owned switches and routers to Company's software applications, which then use the information to send electronic commands back to client's equipment for the purpose of directing or redirecting voice telephone calls, video conferencing calls, and messaging[3] that have come to the client's business. These software applications are housed on servers owned by Company and housed at its out-of-state data center. Company's Cloud Collaboration Services software meets all the elements of an ASP. Company retains custody over and hosts computer software for use by third parties. Therefore, we rule Company is an application service provider when it provides Cloud Collaboration Services.[4]

Hardware

The application of subsection 102(15)(c)(I)(C), discussed above, is limited to software and does not extend to hardware, such as servers and related equipment on which this software operates. Therefore, we next examine whether Company is liable for sales or use tax on charges relating to this equipment. As a general proposition, a person is the ultimate consumer of property if the person uses it to provide a service.[5] The service provider pays sales or use tax when the property is acquired. If the person is leasing the property to a third party, then the person's purchase of the property is an exempt purchase for resale and the person must collect sales tax from the lessee. Company characterizes its transactions with clients as the provisioning of services and not the lease or license of tangible personal property to clients. We agree.

Company identifies three transactions, which it characterizes as services. The first service is Hosting Services which are charges for housing at Company's data center client-owned hardware and software, and includes charges for management of certain software owned by clients. The data center is not located in Colorado.[6] Company also charges fees for connecting its data center to other equipment, which is owned by Company and is not located in Colorado.

The second group of transactions is identified as Managed Services. Company charges clients for monitoring, maintaining, and/or managing client-owned hardware, software, and data. This hardware, software, and data may be located in Colorado. Company may remotely monitor, maintain, or manage this equipment or, in some instances, send Company employees to client's location to perform these services.

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3 For ease of reference, this ruling collectively refers to these services as telephone service.

4 Company also uses software to provide management services but this is not ASP software because Company is clearly the user of this software.

5 See Special Regulation 1 C.C.R 201-5: SR 40 (Service Enterprises) ("Persons engaged in the business of rendering serve are consumers, not retailers, of the tangible persons property which they use incidentally in the rendering of the service." Department regulations, rulings, letters, publications can be viewed at www.Colorado.gov/revenue/tax > Tax Library.

6 Company has not requested a ruling on whether it has nexus for sales tax purposes and we do not rule on the issue here.

The third group of transactions is generally described by Company as Cloud Collaboration Services which manages the transmission of voice, video, messaging and mobility services. Company uses certain Company-owned hardware and software to provide the management. For example, a telephone call to a client's business can be routed to specific client employees depending on information supplied by the caller.

We begin our analysis of the applicable law with Department Regulation 39-26-102(10), in which we define a sale as,

> ... any transaction, except as provided in 26-102.7(b), whereby a person, in exchange for any consideration ... transfers or agrees to transfer all or part of his interest ... in any tangible personal property to any other person; ... Whether the transaction is absolute or conditional, it shall be considered a sale if it transfers from a seller to a buyer the ownership or possession of tangible personal property or specified services. (emphasis added).

Thus, if a retailer transfers possession of tangible personal property to a buyer, there is a taxable sale. One important factor in determining whether possession has been transferred is whether the client exercises dominion and control over the property. For example, Department Regulation 39-26-202 states, in pertinent part,

> Use shall be deemed sufficient for the imposition of the tax when the article purchased is actually used or made available for use after delivery is completed, as when keeping, storing, withdrawing for storage, moving, installing, or performing any other act by which dominion or control over the property is assumed by the purchaser. (emphasis added).

Dominion and control used as factors to determine whether a transaction is subject to sales or use tax is an established principle in Colorado tax law. See, e.g., Romantix v. City of Commerce City, 240 P.3rd 565 (Colo. App. 2010) (The degree of control exercised by a consumer of property is an important factor in determining whether the consumer has engaged in a taxable use of the property); Cinemark USA, Inc. v. Seest, 190 P.3d 793 (Colo. App. 2008); American Multi-media Cinema, Inc. v City of Westminster, 910 P.2d 64 (Colo. App. 1995); Talbots v. Department of Revenue, 95 CA 1892 (Colo. App. 1996) (Taxpayer liable for use tax because it exercised dominion and control over property); Tri-state Generation and Transmission v. Department of Revenue, 81 CA 0216 (Colo. App. 1981) (Taxpayer liable for use tax because it exercised dominion and control over property). See also, Department PLR 11-007 (Control used to determine whether web-based service is a non-taxable service or a taxable sale or use of tangible personal property).

A number of states use the same theoretical framework (dominion and control) to determine whether a user of web hosting software is the consumer of services or is leasing tangible personal property. For example, Utah state law provides that a web hosting company is not liable for sales or use taxes for servers when neither possession nor control of servers is granted to customer. See, Utah Department of Revenue Private Letter Ruling 08-002 (10/06/2009). See also, Arizona Taxpayer

Ruling LR04-010 (11/15/2004) (software is leased when possession or control granted to customer); Texas Policy Ruling 200209314L (09/04/2002) (Web hosting company is providing service when it controls the server, but is leasing the server when the customer controls the server); Florida Technical Assistance Advisement 98A-76 (09/28/1999) (web hosting not taxable because, among other reasons, webhost retains title and control over the host server).

In general, a transaction is more likely to be viewed as a service if the seller retains control over the property. A simplistic example is the rental of truck. If a customer leases a truck to haul material, the customer is exercising dominion and control over the truck and, therefore, is the user and consumer of the truck. However, if the customer enters into a lump sum contract with the company whereby the company provides both the truck and a truck operator, then the transaction is generally considered the provisioning of a service (hauling service) because the company is exercising dominion and control over the truck.[7]

There are a number of provisions in Company's contract with clients that indicate that Company is providing services rather than the rental of equipment. First, Company owns the equipment, which includes the equipment and servers on which the Company's software applications operate. Second, the contract expressly disclaims any intent to create a lease of the equipment to clients.[8] Third, Company is in possession of the equipment and, more importantly, is responsible for its acquisition, configuration, support, operation, and performance. Finally, and more generally, we view the transaction to be one in which the client simply designates the desired outcome and leaves to Company the responsibility to acquire, control, and maintain the equipment necessary to achieve that outcome. As such, this transaction strikes us more as a contract for services rather than a contract to lease equipment.

Our views are influenced by the fact that the Company's equipment is used by many clients and, to a lesser extent, is housed on the Company's premises. Use of the equipment by multiple parties suggests Company is in control of the equipment rather than the numerous clients.[9] Moreover, housing the equipment at the Company's data center indicates that Company possesses the equipment and, therefore, exercises some dominion and control over the property.[10] Had the equipment been housed on

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[7] See, e.g., GIL-13-003 and PLR-11-007. See also, *Romantix v. City of Commercie City*, 240 P.3rd 565 (Colo. App. 2010).

[8] We note that neither the first nor second provisions are determinative. For example, the lessor in a taxable lease of property typically retains ownership over the property. Although the characterization by parties of the nature of the contract can be informative, the Department will examine the realities of the transaction to independently evaluate whether there is a taxable lease.

[9] See, also, Utah Private Letter Ruling 08-002 (10/06/2009) (web host server dedicated to single user is subject to sales tax).

[10] However, and to state the obvious, simply because the equipment is located at the Company's data center or is used by multiple parties is not dispositive. Electronic equipment lends itself to control from remote locations and use by multiple parties. A client could exercise substantial dominion and control over equipment that is not located on client's place of operations and used by multiple parties. The point here is that the converse situation demonstrates dominion and control by the client.

the client's premises and operated for the exclusive use of the client, then we would be more inclined to view this as the lease of tangible personal property rather than a service. This is particularly true when the company's control is limited to monitoring and maintenance. For example, a company that leases burglary and fire detection systems installed on the customer's premises is leasing tangible personal property to the customer rather than providing a non-taxable service (i.e., security services). This is because the customer has dominion and control over the equipment, even though the company retains title to the equipment, monitors the equipment, and warrants its operation.

For these many reasons, we rule that Company is a provider of services and, therefore, the user and consumer of the equipment used to provide the Cloud Collaboration Services, Managed Services, and Hosting services.

Intrastate Telephone Services
Colorado levies sales tax on the provisioning of intrastate telephone and telegraph services. These services are defined as:

> Intrastate telephone and telegraph service is subject to the tax imposed by §39-26-106, C.R.S. whether furnished by public, private, mutual, cooperative, or governmental corporations or agencies. The term "service" includes but is not limited to additional listings, joint-user service, non-talking circuits, leased circuits and facilities, local exchange service (whether on a flat or measured basis), information charges, service connection charges, and any other charges assessed or passed on to the consumer with the exception of charges for installation or repair which are taxed according to the Special Regulation on Contractors. Telephone service is taxable whether either local or toll calls are made or telegrams are sent from telephone pay stations. [11]

Company provides the following description of the configuration of its systems and its interrelationship with their clients' systems. Clients purchase or lease, either through the public switched telephone network or from private line carriers, the necessary local exchange service and circuits and other equipment necessary to connect the transmission of data to and from the client's premise to the Company's data center. Company relies on the client's local area network or wide area network to provide Cloud Collaboration Services throughout the clients' geographic area. A telephone call is not transmitted from the client's premises to the data center. Rather, the voice call is received at the client's premises and, based on electronic commands from Company's data center to the client's LAN or WAN router, routed by client's equipment to the appropriate party. Company maintains a point of presence on a private line carrier at its data center. Clients connect to Company's equipment from their preferred providers using either T-1 or DS3 lines terminated on a client-owned or carrier-provided router, or from client's preferred provider, to the Company's point of presence on the private line carrier. In all cases, the client is the "customer of record" and is responsible for circuit segments up to the carrier's demarcation point in Company's data center. Connections

[11] Department Regulation 39-26-104.1(c).

to the public switched telephone network are through a client's existing or newly-ordered public switched telephone network circuits and phone lines. Public switched telephone network connections are terminated into Company's Cloud Collaboration Services through client-owned, Company managed switches or at the Company's data center. In this latter case, the client is responsible for all circuit segments up to the carrier's demarcation point in Company's data center.

The question before us is whether Company is providing intrastate telephone services because it provides only the routing and data handling functionality relating to voice and other data transmission. Broadly speaking, switches that control the routing and handling of telephone calls are a necessary part of intrastate telephone service. If a traditional telephone service provider purchases or leases servers from a third party to provide this switching functionality, charges by the telephone provider to its clients for such service would be subject to sales tax, even if the telephone provider separately stated the switching charge on its client's invoices. Indeed, it is our understanding that a number of intrastate telecommunications providers provide services substantially similar to those discussed here.

We think the answer is no different if the client separately purchases from different companies the various functionalities that, together, provide intrastate telephone service. For example, assume intrastate telephone service was comprised of two elements: intrastate circuitry and call switching. If a customer leases intrastate circuitry from company A and purchases call switching services from company B, customer has purchased intrastate telephone service. In the present case, clients purchase Company's Cloud Collaboration Services to route telephone calls and purchase the necessary circuitry from either a public switched telephone network provider or a private line carrier to carry those calls. Together, the client purchases intrastate telephone services and the client must pay sales tax on this service. Company, as a retailer of the routing service, must collect state and state-administered local sales taxes from clients located in Colorado. Tax is calculated using charges for Cloud Collaboration Services, Managed Services, and Hosting Services because clients must purchase the latter two services in order to purchase Cloud Collaboration Services.

Company argues that Cloud Collaboration Services should not be taxable because, had a client purchased and operated the equipment, it would not be providing taxable intrastate telephone service. We disagree that the client in such a case is not performing intrastate telecommunications service, but agree that it is not taxable. First, the taxable event is not the purchase of the telecommunications equipment but, rather, the provisioning of intrastate telecommunications services. And in order to incur the tax on such service, there must be a transaction between a seller and a buyer whereby the seller provides the service of intrastate telecommunication. In the case posited by Company, the client, itself, is performing the service and, as such, there is no transaction between the client and another who is providing intrastate telephone service. On the other hand, if the client purchases intrastate telephone service from a third party, such as from Company and a private line carrier, the client has purchased taxable intrastate telephone services and Company, as the retailer, must collect sales tax on such purchase.

Intrastate telephone services are provided in Colorado.
Company offers that, even if its Cloud Collaboration Services are subject to tax as intrastate telephone service, the service is performed outside Colorado where the software applications and equipment reside. We disagree.

The service at issue is intrastate telephone service. Company is providing access to software that routes and otherwise handes intrastate telephone calls that either originate or terminate at the client's place of business in Colorado. That is, Company is providing the functionality necessary to provide intrastate telephone service which is delivered to, and consumed by, clients in Colorado. Moreover, Company performs some aspect of this service when it maintains the equipment necessary for Cloud Collaboration Services at the client's location. Having provided intrastate telephone service to clients in Colorado, Company is liable for sales tax for that service.

Miscellaneous

This ruling applies only to sales and use taxes administered by the Department. Please note that the Department administers state and state-collected city and county sales taxes and special district sales and use taxes, but does not administer sales and use taxes for self-collected home rule cities and counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our web site at www.colorado.gov/revenue/tax for more information about state and local sales taxes.

This ruling is premised on the assumption that Company has completely and accurately disclosed all material facts. The Department reserves the right, among others, to independently evaluate Company's representations. This ruling is null and void if any such representation is incorrect and has a material bearing on the conclusions reached in this ruling. This ruling is subject to modification or revocation in accordance to Department Regulation 24-35-103.5.

Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted version of the ruling.

Sincerely,

Neil L. Tillquist
Colorado Department of Revenue
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Email: neil.tillquist@state.co.us