

FINAL PRIVATE LETTER RULING

REQUEST LETTER

[The request letter below, dated March 9, 2016, incorporates the Taxpayer’s modifications dated April 19, 2016.]

16-001

Office of the Commission
Utah State Tax Commission
210 North 1950 West
Salt Lake City, UT 84134

March 9, 2016

**Re: Utah State Tax Commission Private Letter Ruling Request
Utah Code Ann. § 59-12-104(14) and Utah Admin. R. R865-19S-122**

Dear Sir/Madam:

On behalf of TAXPAYER. (“Taxpayer”), we are requesting the Utah State Tax Commission (the “Commission”) issue a private letter ruling regarding the applicability of Utah Code Ann. § 59-12-104(14)(c) to purchases associated with the potential construction of a new data center campus in the state of Utah. No audit or litigation is currently pending with the Commission relating to Taxpayer. Taxpayer has not previously requested a private letter ruling on the same or similar issue. This request is for proposed new data center purchases, and no taxes have accrued or will accrue prior to the issuance of the ruling with respect to the proposed transactions. Taxpayer deems this private letter ruling request to be a confidential tax matter as described in Utah Code Ann. § 59-1-405(b) and nothing in this request shall be interpreted as a waiver of this confidentiality. While Taxpayer requests that Commission not publicly disseminate the final private letter ruling, in the event Commission cannot legally do so, Taxpayer requests any specific information relating to Taxpayer or Taxpayer’s business be redacted. The following is a summary of facts surrounding our request.

STATEMENT OF FACTS

Taxpayer is proposing to establish a data center campus in Utah. The data center campus will be owned and operated by Taxpayer. Taxpayer is a publicly traded, multi-national Internet company headquartered outside of Utah. Taxpayer is engaged in the business of maintaining (DETAILS REMOVED). Users access Taxpayer’s websites through web browsers via their Internet service

providers or through mobile applications via their mobile carriers. Taxpayer's business is best classified under NAICS 519130, Internet Publishing and Broadcasting and Web Search Portals.

Proposed Project Details

The proposed project would involve the purchase of over #####-acres on one or more parcels of vacant land in the state of Utah and the construction of a new data center campus. The campus could include one or more large data center buildings, all of which would be located on the newly acquired parcel(s) of land. The data center buildings will be specifically designed to house networked computers and data and transaction processing equipment and related infrastructure support equipment, used exclusively to provide data center services to Taxpayer and Taxpayer's affiliates. Equipment purchased for use within the proposed data center campus will include, but not be limited to:

- Computer servers and miscellaneous components. This may include: motherboards, processors, memory, hard drives, and power supplies;
- Fiber optic infrastructure and network equipment. This may include: gateways, routers, network bridges, modems, wireless access points, networking cables, line drivers, switches, hubs, repeaters and fiber optic cable;
- Power equipment and infrastructure. This may include: substations, transformers, voltage reactors, voltage switch equipment, voltage distribution equipment, universal power supplies and supporting infrastructure;
- Backup generators;
- Fire suppression equipment. This may include sprinklers, fire pumps, and corrosion monitoring equipment;
- Security equipment, which may include cameras and card/biometric readers;
- Electrical substations; and
- Cooling equipment for the data center (additional detail provided below).

All of the above equipment purchases would have an economic life of three or more years, as dictated by Taxpayer's internal fixed asset capitalization and depreciation policy and would be necessary and essential to the operation of the data center campus.

Cooling Equipment

Advanced cooling systems are critical to the operability of a data center. In fact, the failure of a critical data center cooling system can lead to downtime, which translates directly into a loss of service and hinders the overall ability of the data center to service user traffic. Due to the volume and density of computer servers in most data centers, heat densities can be up to five times

higher than a typical office setting¹. This environment relies heavily on specially designed cooling systems. In fact, the performance of data center hardware is just as dependent on cooling support as on the network connection. For this reason, traditional comfort cooling systems (used in standard office buildings) are not designed to meet the unique needs of critical data center hardware and can lead to widespread system failures and grossly inflated operating costs. Comfort cooling systems are engineered primarily for the intermittent use required to maintain a comfortable environment. While capable of effectively maintaining acceptable conditions for human occupants, they are not designed to regulate humidity and temperature within precise margins – which is a necessity for efficient data center operation.

Data centers require precision cooling systems, which are designed specifically to meet the needs of dense electrical heat loads. Precision cooling systems are engineered to provide year-round constant cooling, precise humidity control and a higher cooling capacity per square foot. This type of environmental conditioning can utilize a wide range of cooling mediums, but Taxpayer anticipates using a Direct or Indirect Evaporative Cooling System as further described below.

Efficiency in these cooling systems is also integral to a key industry metric used to measure the health of a data center, called Power Usage Effectiveness (PUE). PUE is determined by dividing the amount of power entering a data center by the power used to run the computer infrastructure within it. PUE is therefore expressed as a ratio, with overall efficiency improving as the quotient decreases toward 1.0. Because the primary source of PUE values above 1.0 is driven by cooling loads, these systems are integral to data center operational efficiency.

Direct Evaporative Cooling System

A direct evaporative cooling system uses outside air directly by evaporating water into the airstream to lower the air temperature. The system works by drawing outside air into enter the [sic] facility through an air grill in the second floor penthouse. The air will then pass through a series of air filters and evaporative media. A fan wall then pushes the air through openings in the floor into the the [sic] server area. The system would be comprised of the following components:

- Outside air grills;
- Air filters;
- Evaporative humidifiers;
- Bypass dampers;
- Drift eliminators;
- Piping, tubing and valves;

¹ Emerson Network Power – “Precision versus Comfort Cooling - Choosing a Cooling System to Support Business-Critical IT Environments”. http://www.emersonnetworkpower.com/documentation/en-us/brands/liebert/documents/white%20papers/data-center-cooling_24644-r09-10.pdf.

- Flow-setting water valves;
- Equipment stands;
- Fans;
- Power connectivity equipment and low voltage power distribution systems; and
- Monitoring and management systems (water/electrical meters, temperature sensors, and wiring to the building management system).

Indirect Evaporative Cooling System

An indirect evaporative cooling system uses outdoor air indirectly through a specially designed series of heat exchanges enabling cooling to take place without outdoor air entering the data hall. Instead of pushing outside air onto the computer floor, indirect evaporative cooling cools the outside air, which is then passed over a heat exchanger, to extract the heat from the air that circulates through the computer hardware. The system would be comprised of the following components:

- Evaporative indirect heat exchangers;
- Motorized air dampers;
- Fans;
- Ductwork;
- Rooftop equipment and support systems (mounting equipment, downpipes, guttering, sloping to avoid puddling, and external flanges for duct connections);
- Power connectivity equipment and low voltage power distribution systems; and
- Monitoring and management systems (water/electrical meters, temperature sensors, and wiring to the building management system).

RULINGS REQUESTED

Based on the facts provided above, the following rulings are requested:

1. Taxpayer's business meets the description provided in NAICS Code 518112, Web Search Portals, of the 2002 North American Industry Classification System of the federal Executive

Office of the President, Office of Management and Budget (hereafter referred to as “2002 NAICS Code 518112”).²

2. The proposed data center campus in Utah is a qualified “Establishment” as defined in Utah Code Ann. § 59-12-104(14)(c)(i) and Utah Admin. R. R865-19S-122(1)(a).
3. The proposed data center campus in Utah is also a “New or expanding establishment” as defined in Utah Admin. R. R865-19S-122.
4. Given that Taxpayer meets the description provided in 2002 NAICS Code 518112 and the proposed data center campus in Utah is both an “Establishment” and a “New or expanding establishment,” the identified purchases made by Taxpayer of data center equipment to be used in the operation of the proposed data center will be exempt from sales and use tax as provided under Utah Code Ann. § 59-12-104(14)(c)(ii) and Utah Admin. R. R865-19S-122.

STATEMENT OF AUTHORITIES AND ANALYSIS

Establishment

Utah Code Ann. § 59-12-104(14):

“(c) amounts paid or charged for a purchase or lease:

(i) by an establishment:

(A) described in NAICS Code 518112, Web Search Portals, of the 2002 North American Industry Classification System of the federal Executive Office of the President, Office of Management and Budget; and

(B) located in the state; and...³”.

2002 NAICS Definition – 518112 Web Search Portals:

“Establishments in this industry operate web sites that use a search engine to generate and maintain extensive databases of Internet addresses and content in an easily searchable format. Web search portals often provide additional Internet services, such as e-mail, connections to other web sites, auctions, news, and other limited content, and serve as a home base for Internet users.⁴”

Utah Admin. R. R865-19S-122:

² United States Census Bureau – North American Industry Classification System (2002). <https://www.census.gov/cgi-bin/sssd/naics/naicsrch?code=518112&search=2002%20NAICS%20Search>.

³ Utah Code Ann. § 59-12-104(14)(c)

⁴ United States Census Bureau – North American Industry Classification System (2002). <https://www.census.gov/cgi-bin/sssd/naics/naicsrch?code=518112&search=2002%20NAICS%20Search>.

“(1) *Definitions.*

- (a) *‘Establishment’ means a unit of operations that is generally at a single physical location in Utah, where qualifying activities are performed. If a business operates in more than one location (e.g., branch or satellite offices), each physical location is considered separately from any other locations operated by the same business....⁵”.*

Taxpayer believes the proposed data center campus is a qualified establishment as defined above. First, Taxpayer operates (DETAILS REMOVED). Taxpayer is of the opinion that its business falls within the 2002 NAICS 518112. Since 518112 expired in 2007, Taxpayer currently associates itself with NAICS 519130, which is the successor code to NAICS 518112. Given that the data center campus will be used exclusively for Taxpayer’s websites, Taxpayer believes the proposed business activities fall under NAICS 518112. Secondly, the proposed data center campus and activities as described above will be located at a single physical location in Utah albeit multiple data center buildings on one or more parcels of land.

New or expanding establishment

Utah Admin. R. R865-19S-122:

“(1) *Definitions...*

- (c) *“New or expanding establishment” means:*

(i)

(A) *the creation of a new web search portal establishment in this state;*
or

(B) *the expansion of an existing Utah web search portal establishment if the expanded establishment increases services or is substantially different in nature, character, or purpose from the existing Utah web search portal establishment.*

- (ii) *The operator of a web search portal establishment who closes operations at one location in this state and reopens the same establishment at a new location does not qualify as a new or expanding establishment without demonstrating that the move meets the conditions set forth in Subsection (1)(c)(i)⁶.”*

The proposed data center campus is a new establishment in the state of Utah.

Exempt purchases

Utah Code Ann. § 59-12-104(14):

⁵ Utah Admin. R. R865-19S-122(1)(a)

⁶ Utah Admin. R. R865-19S-122(1)(c)

“(c) amounts paid or charged for a purchase or lease: ...

(ii) machinery, equipment, or normal operating repair or replacement parts if the machinery, equipment, or normal operating repair or replacement parts:

(A) are used in the operation of the web search portal; and

(B) have an economic life of three or more years;⁷”.

Utah Admin. R. R865-19S-122:

“(2) The exemption for certain purchases by a web search portal establishment does not apply to purchases of items of tangible personal property that become part of the real property.

(3) Purchases of qualifying machinery and equipment are treated as purchases of tangible personal property under R865-19S-58, even if the item is affixed to real property under installation.

(4) Machinery and equipment used for non-qualifying activities are eligible for the exemption if the machinery and equipment are primarily used in qualifying activities.⁸”

Based on the above, Taxpayer is of the opinion that the following will be exempt from sales and use taxes for the proposed data center campus:

- Computer servers and miscellaneous components;
- Network equipment and miscellaneous components;
- Fiber optic infrastructure;
- Cooling equipment;
- Power infrastructure and backup generators;
- Fire suppression equipment;
- Security equipment; and
- Electrical substations.

Each of the proposed purchases will be primarily used at, installed in, or incorporated into the proposed data center campus and will be separately identifiable from the real property, despite being affixed to the real property in some circumstances. All of the proposed purchases are expected to have economic lives greater than three years, as evidenced by Taxpayer’s internal fixed asset capitalization and depreciation policy. Lastly, all of the proposed purchases would be necessary and essential to the operation of the data center.

STATEMENT OF CONTRARY AUTHORITIES

We are not aware of any contrary authorities relating to this request.

⁷ Utah Code Ann. § 59-12-104(14)

⁸ Utah Admin. R. R865-19S-122(2) – (4)

CONCLUSION

Based on the analysis above, Taxpayer believes that the proposed data center campus is a qualified establishment, located in the state of Utah and entitled to the exemption detailed in Utah Code Ann. § 59-12-104(14) and Utah Admin. R. R865-19S-122. Taxpayer understands that this exemption does not apply to purchases with economic lives less than three years or those purchases of tangible personal property that become part of real property.

Thank you in advance for your cooperation and consideration of this request. Should you or your staff have any questions or concerns, please do not hesitate to contact NAME-1 at PHONE NUMBER.

Respectfully submitted,

TAXPAYER.

By:_____

RESPONSE LETTER

PRIVATE LETTER RULING 16-001

July 1, 2016

NAME-2
Vice President
TAXPAYER
WEB ADDRESS

RE: Private Letter Ruling Request—Application of the Exemption Found in Subsection (14)(c) of Utah Code Ann. § 59-12-104 to the Situation Presented

Dear NAME-2:

This letter is in response to your request for a private letter ruling on behalf of TAXPAYER. (“Taxpayer”) about the applicability of subsection (14)(c) of § 59-12-104 to the Taxpayer’s purchases of certain items for the Taxpayer’s proposed new data center campus to be located in Utah. Our response includes the following sections: I. Facts, II. Issues, III. Applicable Law, IV. Analysis, and V. Conclusion.

I. Facts

You have provided information that the “Taxpayer’s business is best classified under NAICS 519130, Internet Publishing and Broadcasting and Web Search Portals.” You explained the “Taxpayer’s business meets the description provided in [the 2002] NAICS Code 518112, Web Search Portals.” You explained the “Taxpayer is a publicly traded, multi-national Internet company headquartered outside of Utah” and “is engaged in the business of maintaining an online social networking community by providing a platform for users to share information and in certain instances search for information.” You explained that Taxpayer’s “[u]sers access Taxpayer’s websites through web browsers via their Internet service providers or through mobile applications via their mobile carriers.” (ADDITIONAL INFORMATION REDACTED).

You explained that the Taxpayer is considering whether to build a new data center campus in Utah. Specifically, you explained the following:

Proposed Project Details

The proposed project would involve the purchase of over #####-acres on one or more parcels of vacant land in the state of Utah and the construction of a new data center campus. The campus could include one or more large data center buildings, all of which would be located on the newly acquired parcel(s) of land. The data center buildings will be specifically designed to house networked

computers and data and transaction processing equipment and related infrastructure support equipment, used exclusively to provide data center services to Taxpayer and Taxpayer's affiliates. Equipment purchased for use within the proposed data center campus will include, but not be limited to:

- Computer servers and miscellaneous components. This may include: motherboards, processors, memory, hard drives, and power supplies;
- Fiber optic infrastructure and network equipment. This may include: gateways, routers, network bridges, modems, wireless access points, networking cables, line drivers, switches, hubs, repeaters and fiber optic cable;
- Power equipment and infrastructure. This may include: substations, transformers, voltage reactors, voltage switch equipment, voltage distribution equipment, universal power supplies and supporting infrastructure;
- Backup generators;
- Fire suppression equipment. This may include sprinklers, fire pumps, and corrosion monitoring equipment;
- Security equipment, which may include cameras and card/biometric readers;
- Electrical substations; and
- Cooling equipment for the data center (additional detail provided below).

All of the above equipment purchases would have an economic life of three or more years, as dictated by Taxpayer's internal fixed asset capitalization and depreciation policy and would be necessary and essential to the operation of the data center campus.

Cooling Equipment

Advanced cooling systems are critical to the operability of a data center. In fact, the failure of a critical data center cooling system can lead to downtime, which translates directly into a loss of service and hinders the overall ability of the data center to service user traffic. Due to the volume and density of computer servers in most data centers, heat densities can be up to five times higher than a typical office setting. This environment relies heavily on specially designed cooling systems. In fact, the performance of data center hardware is just as dependent on cooling support as on the network connection. For this reason, traditional comfort cooling systems (used in standard office buildings) are not designed to meet the unique needs of critical data center hardware and can lead to widespread system failures and grossly inflated operating costs. Comfort cooling systems are engineered primarily for the intermittent use required to maintain a comfortable

environment. While capable of effectively maintaining acceptable conditions for human occupants, they are not designed to regulate humidity and temperature within precise margins – which is a necessity for efficient data center operation.

Data centers require precision cooling systems, which are designed specifically to meet the needs of dense electrical heat loads. Precision cooling systems are engineered to provide year-round constant cooling, precise humidity control and a higher cooling capacity per square foot. This type of environmental conditioning can utilize a wide range of cooling mediums, but Taxpayer anticipates using a Direct or Indirect Evaporative Cooling System as further described below.

Efficiency in these cooling systems is also integral to a key industry metric used to measure the health of a data center, called Power Usage Effectiveness (PUE). PUE is determined by dividing the amount of power entering a data center by the power used to run the computer infrastructure within it. PUE is therefore expressed as a ratio, with overall efficiency improving as the quotient decreases toward 1.0. Because the primary source of PUE values above 1.0 is driven by cooling loads, these systems are integral to data center operational efficiency.

Direct Evaporative Cooling System

A direct evaporative cooling system uses outside air directly by evaporating water into the airstream to lower the air temperature. The system works by drawing outside air into . . . the facility through an air grill in the second floor penthouse. The air will then pass through a series of air filters and evaporative media. A fan wall then pushes the air through openings in the floor into the . . . server area. The system would be comprised of the following components:

- Outside air grills;
- Air filters;
- Evaporative humidifiers;
- Bypass dampers;
- Drift eliminators;
- Piping, tubing and valves;
- Flow-setting water valves;
- Equipment stands;
- Fans;

- Power connectivity equipment and low voltage power distribution systems; and
- Monitoring and management systems (water/electrical meters, temperature sensors, and wiring to the building management system).

Indirect Evaporative Cooling System

An indirect evaporative cooling system uses outdoor air indirectly through a specially designed series of heat exchanges enabling cooling to take place without outdoor air entering the data hall. Instead of pushing outside air onto the computer floor, indirect evaporative cooling cools the outside air, which is then passed over a heat exchanger, to extract the heat from the air that circulates through the computer hardware. The system would be comprised of the following components:

- Evaporative indirect heat exchangers;
- Motorized air dampers;
- Fans;
- Ductwork;
- Rooftop equipment and support systems (mounting equipment, downpipes, guttering, sloping to avoid puddling, and external flanges for duct connections);
- Power connectivity equipment and low voltage power distribution systems; and
- Monitoring and management systems (water/electrical meters, temperature sensors, and wiring to the building management system).

....

Each of the proposed purchases will be primarily used at, installed in, or incorporated into the proposed data center campus and will be separately identifiable from the real property, despite being affixed to the real property in some circumstances. All of the proposed purchases are expected to have economic lives greater than three years, as evidenced by Taxpayer's internal fixed asset capitalization and depreciation policy. Lastly, all of the proposed purchases would be necessary and essential to the operation of the data center.

(Footnote removed.)

II. Issues

You presented the following issues:

1. Whether the Taxpayer is described in the 2002 NAICS Code 518112, Web Search Portals.
2. Whether “the identified purchases made by Taxpayer of data center equipment to be used in the operation of the proposed data center will be exempt from sales and use tax[es].”

In this private letter ruling, the Commission concludes the following:

1. The Taxpayer is described in the 2002 NAICS Code 518112, Web Search Portals.
2. The taxability of the Taxpayer’s purchases is as follows:

<u>Items</u>	<u>Whether exempt by § 59-12-104(14)(c)</u>
Computer servers and miscellaneous components	Exempt
Fiber optic infrastructure and network equipment	Exempt
Power equipment and infrastructure	Exempt
Backup generators	Exempt
Fire suppression equipment	Not Exempt
Security equipment	Not Exempt
Electrical substations	Exempt
Cooling equipment for the data center	Not Exempt

The analyses for these conclusions are located in section IV. Analysis.

III. Applicable Law

Utah Code Ann. § 59-12-103(1) imposes Utah sales and use taxes as follows, in part:

A tax is imposed on the purchaser . . . for amounts paid or charged for the following transactions:

- (a) retail sales of tangible personal property made within the state;
-
- (k) amounts paid or charged for leases or rentals of tangible personal property if within this state the tangible personal property is:
 - (i) stored;
 - (ii) used; or
 - (iii) otherwise consumed;

- (l) amounts paid or charged for tangible personal property if within this state the tangible personal property is:
 - (i) stored;
 - (ii) used; or
 - (iii) consumed . . .

....

Utah Code Ann. § 59-12-104(14)(a), (c) includes the following exemptions from Utah sales and use taxes:

- (a) amounts paid or charged for a purchase or lease:
 - (i) by a manufacturing facility located in the state; and
 - (ii) of machinery, equipment, or normal operating repair or replacement parts if the machinery, equipment, or normal operating repair or replacement parts have an economic life of three or more years and are used:
 - (A) in the manufacturing process to manufacture an item sold as tangible personal property; or
 - (B) for a scrap recycler, to process an item sold as tangible personal property;

....

- (c) amounts paid or charged for a purchase or lease:
 - (i) by an establishment:
 - (A) described in NAICS Code 518112, Web Search Portals, of the 2002 North American Industry Classification System of the federal Executive Office of the President, Office of Management and Budget; and
 - (B) located in the state; and
 - (ii) of machinery, equipment, or normal operating repair or replacement parts if the machinery, equipment, or normal operating repair or replacement parts:
 - (A) are used in the operation of the web search portal; and
 - (B) have an economic life of three or more years;

Utah Administrative Code R865-19S-122, addressing certain purchases for web search portals, states the following, in part:

- (1) Definitions.
 - (a) "Establishment" means a unit of operations that is generally at a single physical location in Utah, where qualifying activities are performed. If a business operates in more than one location (e.g., branch or satellite offices), each physical location is considered separately from any other locations operated by the same business.
 - (b) "Machinery and equipment" means electronic or mechanical devices having an economic life of three or more years including any accessory that controls the operation of the machinery and equipment.

....

- (2) The exemption for certain purchases by a web search portal establishment does not apply to purchases of items of tangible personal property that become part of the real property.
- (3) Purchases of qualifying machinery and equipment are treated as purchases of tangible personal property under R865-19S-58, even if the item is affixed to real property upon installation.
- (4) Machinery and equipment used for non-qualifying activities are eligible for the exemption if the machinery and equipment are primarily used in qualifying activities.
- (5) The entity claiming the exemption shall retain records to support the claim that the machinery and equipment are qualified for exemption from sales and use tax under the provisions of this rule and Section 59-12-104.

Utah Administrative Code R865-19S-85, addressing certain purchase for manufacturing, states the following, in part:

(1) Definitions:

....

(b) "Machinery and equipment" means:

....

(ii) any accessory that is essential to a continuous manufacturing process. Accessories essential to a continuous manufacturing process include:

- (A) bits, jigs, molds, or devices that control the operation of machinery and equipment; and
- (B) gas, water, electricity, or other similar supply lines installed for the operation of the manufacturing equipment, but only if the primary use of the supply line is for the operation of the manufacturing equipment.

....

- (2) The sales and use tax exemption for the purchase or lease of machinery and equipment by a manufacturing facility applies only to purchases or leases of tangible personal property used in the actual manufacturing process.
 - (a) The exemptions do not apply to purchases of items of tangible personal property that become part of the real property in which the manufacturing operation is conducted.
 - (b) Purchases of qualifying machinery and equipment are treated as purchases of tangible personal property under R865-19S-58, even if the item is affixed to real property upon installation.

....

Both R865-19S-122 and R865-19S-85 reference Utah Administrative Code R865-19S-58. R865-19S-58 addresses "items that remain tangible personal property even when attached to real property." The current version of R865-19S-58 can be accessed through tax.utah.gov.

IV. Analysis

This section, first, explains the Taxpayer meets the NAICS code requirement found in subsection (14)(c)(i) of § 59-12-104 and, second, explains which of the Taxpayer's purchases meet the requirements of subsection (14)(c)(ii) of § 59-12-104.

A. The Taxpayer is Described in 2002 NAICS Code 518112, Web Search Portals.

The Commission agrees that the Taxpayer meets the NAICS code requirement found in subsection (14)(c)(i) of § 59-12-104. Subsection (14)(c)(i)(A) of § 59-12-104 requires, the establishment purchasing or leasing the equipment to be “an establishment . . . described in [2002] NAICS Code 518112, Web Search Portals.” Subsection (14)(c)(i)(B) of § 59-12-104 requires the establishment to be “located in the state.” Subsection (1)(a) of R865-19S-122 defines “[e]stablishment” as follows:

"Establishment" means a unit of operations that is generally at a single physical location in Utah, where qualifying activities are performed. If a business operates in more than one location (e.g., branch or satellite offices), each physical location is considered separately from any other locations operated by the same business.

Based on your description of the Taxpayer's activities, the Taxpayer would meet the requirement found in subsection (14)(c)(i)(A) of § 59-12-104. Your description provides the following. The Taxpayer “maintain[s] an online social networking community by providing a platform for users to share information and in certain instances search for information.” The “[u]sers [of the Taxpayer] access [the] Taxpayer's websites through web browsers via their Internet service providers or through mobile applications via their mobile carriers.” The “information searching [is] through [the Taxpayer's] websites . . . [The] Taxpayer's platform not only allows individuals and business to share content, it also has search functionality that allows users to query various keywords and return relevant search results relating to people, photos, videos, etc.” For subsection (14)(c)(i)(B), the Taxpayer will be “located in the state” through its development of the proposed new data center in Utah. You have indicated that the Taxpayer will be the entity purchasing the equipment and owning and operating the proposed data center.

B. Utah Sales and Use Taxability of the Taxpayer's Purchases.

As analyzed further below, the taxability of the Taxpayer's purchases is as follows:

<u>Items</u>	<u>Whether exempt by § 59-12-104(14)(c)</u>
Computer servers and miscellaneous components	Exempt
Fiber optic infrastructure and network equipment	Exempt
Power equipment and infrastructure	Exempt
Backup generators	Exempt
Fire suppression equipment	Not Exempt
Security equipment	Not Exempt
Electrical substations	Exempt
Cooling equipment for the data center	Not Exempt

In general, subsection (14)(c)(ii) of § 59-12-104 requires a taxpayer's purchases be of "machinery, equipment, or normal operating repair or replacement parts" that "are used in the operation of the web search portal" and "have an economic life of three or more years." For "machinery [and] equipment," subsection (1)(b) of R865-19S-122 defines "[m]achinery and equipment" as "electronic or mechanical devices having an economic life of three or more years including any accessory that controls the operation of the machinery and equipment." R865-19S-122 does not have additional language about accessories; however, R865-19S-85, which concerns a similar exemption for manufacturing equipment, does. For background, R865-19S-85 applies to the exemption found in § 59-12-104(14)(a) for purchases of certain manufacturing equipment. Under subsection (1)(b) of R865-19S-85, the administrative rule defines machinery and equipment, in part, to include the following:

- (ii) any accessory that is essential to a continuous manufacturing process. Accessories essential to a continuous manufacturing process include:
 - (A) bits, jigs, molds, or devices that control the operation of machinery and equipment; and
 - (B) gas, water, electricity, or other similar supply lines installed for the operation of the manufacturing equipment, but only if the primary use of the supply line is for the operation of the manufacturing equipment.

Because of the similarities between subsections (14)(a) and (c) of § 59-12-104 and between the administrative rules R865-19S-122 and R865-19S-85, subsection (1)(b) of R865-19S-85 provides useful guidance for interpreting "accessory" as that term is used in subsection (1)(b) of R865-19S-122, for web search portals. After considering R865-19S-85, a supply line can be an accessory and included in the definition of "machinery and equipment" for R865-19S-122 if both of the following are true: first, the supply line "controls the operation of the machinery and equipment" "used in the operation of the web search portal" (R865-19S-122(1)(b) and § 59-12-104(14)(c)(ii)(A)) and second, "the primary use of the supply line is for the operation of [that machinery and equipment]" (R865-19S-85(1)(b)(ii)(B)). Notably, the "primary use" language found in subsection (1)(b)(ii)(B) of R865-19S-85 for supply lines is consistent with the "primarily used" language found in section (4) of R865-19S-122 for web search portals. Under section (4) of R865-19S-122, machinery and equipment "used for non-qualifying activities are [still] eligible for the exemption if the machinery and equipment are primarily used in qualifying activities." In addition to the discussion above, R865-19S-122 also provides the following

additional guidance. Under sections (2)-(3) of R865-19S-122, the purchases qualifying for the exemption cannot “become part of the real property” but can be “affixed to real property.”

The purchases of **computer servers and miscellaneous components** and of **fiber optic infrastructure and network equipment** (“computer equipment”) are exempt under subsection (14)(c) of § 59-12-104. Based on the facts provided, these items are “machinery [and] equipment” that “are used in the operation of the web search portal” and “have an economic life of three or more years” (*see* § 59-12-104(14)(c)(ii)). For the three-or-more-years life, you represented “[a]ll of the proposed purchases are expected to have economic lives greater than three years, as evidenced by Taxpayer’s internal fixed asset capitalization and depreciation policy.” For the “use[] in the operation of the web search portal,” you provided the data center’s only operation is for the web search portal, and you described all proposed purchases as “necessary and essential to the operation of the data center.” No facts presented suggest the data center’s computer equipment will be used in activities other than in the operation of the web search portal.

The purchases of **power equipment and infrastructure, backup generators,** and **electrical substations** (“power equipment”) are exempt under subsection (14)(c) of § 59-12-104. The power equipment provides directly through supply lines the energy necessary to power the computer servers, fiber optic infrastructure, and network equipment. Based on the facts provided, the power equipment is qualifying machinery and equipment because it is an accessory similar to the supply lines mentioned in subsection (i)(b)(2)(B) of R865-19S-85. Furthermore, the primary use of the power equipment is to power the computer servers rather than to power other items. Finally, the power equipment has a three-or-more-years life based on your statement that “the proposed purchases are expected to have economic lives greater than three years, as evidenced by Taxpayer’s internal fixed asset capitalization and depreciation policy.”

As a reminder, the Taxpayer is required under section (5) of R865-19S-122 to retain records showing that the Taxpayer’s exempt purchases meet the requirements of R865-19S-122 and § 59-12-104. This recordkeeping requirement includes documenting the primary use of the machinery, equipment, and related accessories.

The purchases of the **fire suppression equipment** and the **security equipment** are not exempt under subsection (14)(c) of § 59-12-104. These items are not “used in the operation of the web search portal,” as required by § 59-12-104(14)(c)(ii)(A). Instead, these items are primarily used to provide an environment for the computer servers, fiber optic infrastructure, and network equipment to operate the web search portal. The fire suppression and security equipment are not accessories to the computer equipment. They do not directly control the operation of the computer equipment and they are not physically connected to the computer equipment. Additionally, based on the limited facts presented, the Commission cannot conclude that the fire suppression and security equipment are merely affixed to the real property and do not become part of the real property.

The purchases of the **cooling equipment for the data center** are not exempt under subsection (14)(c) of § 59-12-104. The cooling equipment is not “machinery [or] equipment . . . used in the operation of the web search portal,” as required by § 59-12-104(14)(c)(ii)(A).

Furthermore, the cooling equipment is not an accessory to the computer equipment operating the web search portal. The cooling equipment does not *directly* control the operation of the computer equipment. Instead, the cooling equipment cools the environment, which causes the computer equipment to function properly. Similarly, the cooling equipment is not physically connected to the computer equipment. Instead, the cooling equipment is physically integrated with and/or connected to the real property. The cooling equipment is unlike the power equipment, which is an accessory to the computer equipment operating the web search portal. The power equipment is directly, physically connected to the computer equipment through supply lines for the purpose of providing energy to the computer equipment. The cooling equipment, on the other hand, is not physically connected to the computer equipment and does not supply energy to operate the computer equipment.

We agree that the cooling equipment is critical to the correct function of the computer equipment operating the web search portal. However, the cooling equipment is not operating the web search portal; it is creating the environment for the computer equipment to operate the web search portal. Equipment creating an environment for a qualifying activity is not the same as the equipment performing that activity. The Order for Appeal No. 00-1158 addresses a similar situation for the manufacturing equipment exemption, currently found in § 59-12-104(14)(a).¹ In Appeal No. 00-1158, a taxpayer purchased “‘Clean Room Equipment,’ which [included] machinery and equipment installed to heat, cool, humidify, filter, condition and balance the air required for the manufacturing process.” According to that Order, “[t]he clean room [was] a removable room within the exterior of the building. The floor, walls, and ceiling of the clean room [were] specifically designed to create the elements required for the manufacture of semiconductors.” Thus, the clean room equipment was required for the manufacturing process to occur. The Commission found that the clean room equipment was not used in the actual manufacturing process even though it created the necessary environment. The Commission explained, “[The items of clean room equipment] are used primarily to provide an environment in which the manufacturing process takes place. Those items are not part of the actual physical conversion of raw materials into semiconductor products, and are not part of the physical manufacturing process.” Similarly for the Taxpayer’s cooling equipment, the cooling equipment is used to provide the environment in which the web search portal can operate, but the cooling equipment is not used in the operation of the web search portal. The cooling equipment is not physically connected to the computer equipment operating the web search portal.

In addition to the reasons presented above, the purchases of the cooling equipment may not qualify for an additional reason, as well. Based on the facts presented, the Commission cannot conclude the cooling equipment is merely affixed to the real property and does not become part of the real property. In *Morton International*, the Utah Supreme Court sustained “the Commission’s determination that the shells of Morton’s [production] facilities [i.e., the foundations, walls, floors, and ceilings] do not constitute equipment” for the manufacturing equipment exemption. *Morton International, Inc. v. Auditing Division of the Utah State Tax Commission*, 814 P.2d 581, 594 (Utah 1991). The Court ruled against “Morton’s argument . . . that the shells of its production facilities are so specialized and so intricately connected to the function of the machinery that they do not constitute buildings, in the traditional sense, but are essentially equipment.” *Id.* at 592.

¹ Prior commission decisions are available through the tax.utah.gov website.

V. Conclusion

This private letter ruling concludes the following:

1. The Taxpayer is described in 2002 NAICS Code 518112, Web Search Portals.
2. The taxability of the Taxpayer's purchases is as follows:

<u>Items</u>	<u>Whether exempt by § 59-12-104(14)(c)</u>
Computer servers and miscellaneous components	Exempt
Fiber optic infrastructure and network equipment	Exempt
Power equipment and infrastructure	Exempt
Backup generators	Exempt
Fire suppression equipment	Not Exempt
Security equipment	Not Exempt
Electrical substations	Exempt
Cooling equipment for the data center	Not Exempt

The Tax Commission's conclusions are based on the facts as you described them and the Utah law currently in effect. Should the facts be different or if the law were to change, a different conclusion may be warranted. If you feel we have misunderstood the facts as you have presented them, you have additional facts that may be relevant, or you have any other questions, please feel free to contact the Commission.

Additionally, you may also appeal the private letter ruling in the following two ways.

First, you may file a petition for declaratory order, which would serve to challenge the Commission's interpretation of statutory language or authority under a statute. This petition must be in written form, and submitted within thirty (30) days after the date of this private letter ruling. You may submit your petition by any of the means given below. **Failure to submit your petition within the 30-day time frame could forfeit your appeal rights and will be deemed a failure to exhaust your administrative remedies.** Declaratory orders are discussed in Utah Administrative Code R861-1A-34 C.2., available online at <http://tax.utah.gov/commission/effective/r861-01a-034.pdf>, and in Utah Administrative Code R861-1A-31, available online at <http://tax.utah.gov/commission/effective/r861-01a-031.pdf>.

Second, you may file a petition for redetermination of agency action if your private letter ruling leads to an audit assessment, a denial of a claim, or some other agency action at a division level. This petition must be written and may use form TC-738, available online at <http://tax.utah.gov/forms/current/tc-738.pdf>. Your petition must be submitted by any of the means given below, within thirty (30) days, generally, of the date of the notice of agency action that describes the agency action you are challenging.

You may access general information about Tax Commission Appeals online at <http://tax.utah.gov/commission-office/appeals>. You may file an appeal through any of the means provided below:

- **Best way**—by email: taxappeals@utah.gov
- By mail: Tax Appeals
USTC
210 North 1950 West
Salt Lake City, UT 84134
- By fax: 801-297-3919

For the Commission,²

John L. Valentine
Commissioner Chair

JLV/aln
16-001

² For this private letter ruling, the members of the Commission are Commission Chair Valentine, Commissioner Cragun, and Commissioner Pero. Commissioner Rockwell is recused.