

REQUEST LETTER

March 20, 2007

07-002

NAME
ADDRESS
PHONE

Dear TP REP

Subject: Application of Utah Sales Tax Related to Music and Service

My client ("Taxpayer") is in the electronic jukebox and music service business. Simply, Taxpayer sells digital jukeboxes to its customers ("Operators") that contain a hard drive pre-loaded with thousands of songs available for play by customers upon inserting a coin into the jukebox. Additional songs can be downloaded via the Internet onto the hard drive. Charges by Taxpayer for the music on each jukebox, whether on the hard drive at the time of the sale of the jukebox, or downloaded at the request of the Operator or customer, are based on a variety of music service packages as noted below. Technical support service is included with the purchase of each jukebox at no charge to Operators.

Music Service Packages:

- A. Fixed Rate, New Fixed Rate, Fixed Rate 2006 – Operators are charged a weekly base fee of \$12.95 plus \$0.04 each time a song is played ("per play"). Operators are entitled to a fixed number of free music downloads annually.
- B. Ultra 16 – Operators are charged a weekly base fee of \$12.95 plus 16% of revenue from the total coinage (intake). Operators are entitled to a fixed number of free music downloads annually.
- C. Elite, New Elite, Fixed Percentage Program – there is no base fee on these plans. Operators are charged between 20% and 23% revenue on total coinage (intake), depending on the plan. Operators are entitled to a fixed number of free music downloads annually.

Separately Stated and Charged For Additional Services:

- D. Additional Song Downloads – In each of the music service packages noted above, existing Operators are entitled to a fixed number of free music downloads annually. Should Operators exceed their free annual download allotment, they will incur a separately stated charge of \$1.50 for each additional song downloaded onto the hard drive.
- E. Per Play Fee (Tune Central) – Operators electing the Fixed Rate, Elite, Ultra16,

and/or Fixed Percentage music packages may incur a separately stated charge for each “per play fee.” A per play is a charge incurred each time a song, accessed from Taxpayer’s Tune Central” database, is chosen and played by a customer. The fees differ whether Tune Central is leased or purchased. This charge is never passed on to the customer, but absorbed by the Operator.

- F. Tune Central – Taxpayer’s music access database allows a customer to access said database to search thousands of music titles by name, artist, or album. Customers perform the search, make their selection, and insert coins to have their song played. While the song is accessed from the database (entity within the jukebox body) it is never downloaded to the Operators hard drive. No copies (either hard or digital) are maintained by the Operator after the play has been completed. This is a one-time play option and a separate charge or credit is used by the customer each time the customer searches, and chooses to play a song.
- G. Tune Central (Gen III) – taxpayer’s on-line music access database allows a customer to access the main frame database (the Internet) to search for music titles by name, artist, album, or genre. A selection is made, coins are inserted and a song is played. It is not downloaded onto the Operators hard drive, and no copies are maintained after the play has been completed. This is a one-time play option and a separate charge or credit is used by the customer each time the customer searches, and chooses to play a song.
- H. Background Music – Background music is a separately charged for service available with the Ultra 16, Elite, New Elite and Fixed Percentage Plan music packages. The charge is calculated on a graduated rate based on the percentage of total Jukebox plays. This charge is never passed on to the customer, but absorbed by the Operator.
- I. Telephone support – Telephone support services provide Operators twenty-four hour technical telephone support, an exchange of damaged or defective parts and/or any applicable software upgrades (in both tangible and intangible format), and on-site field service technicians.

Question:

We understand that the sale and lease of the jukebox is subject to Utah sales tax. Our question is, will Utah require Taxpayer to collect and remit sales tax, or self-assess use tax on the following music service packages and/or separately stated and charged for additional services, as described above:

- A. Fixed rate, New Fixed Rate, Fixed Rate 2006
- B. Ultra 16
- C. Elite, New Elite, Fixed Percentage Program
- D. Additional Song downloads
- E. Per Play Fee
- F. Tune Central
- G. Tune Central Gen III
- H. Background Music
- I. Telephone Support

Thank you for your assistance with this issue. Because Taxpayer wishes to correctly comply with its Utah sales tax collection and remittance obligation, your attention to this matter is greatly appreciated.

If you have any questions, or require further information, please contact me directly at PHONE.

Best Regards,

NAME
ADDRESS

RESPONSE LETTER

May 30, 2007

NAME
ADDRESS

RE: Private Letter Ruling 07-002
Application of Sales and Use Tax to Music Downloads and Other Related Services

Dear NAME,

We have received your letter requesting a ruling regarding the applicability of Utah sales and use tax to a variety of music service packages that your client, henceforth "Taxpayer," provides to its customers. You noted correctly that the sale and lease of the jukebox is subject to Utah sales tax. However, you asked whether the Utah sales and use tax is applicable to nine different transactions related to the various music service packages, and whether Taxpayer should collect and remit sales tax, or self-assess use tax.

It should be noted that the ruling in this letter is not intended to be a statement of broad Tax Commission Policy. It is an interpretation of the tax law as it relates to the facts presented in your request letter and the assumptions stated in this ruling. If the facts or assumptions are not correctly described in this ruling, please let us know so we can assure a more accurate response to your circumstances.

FACTS

You stated the following facts in your request letter. Taxpayer is in the electronic jukebox and music service business. It sells electronic jukeboxes to its customers (“operators”) and these jukeboxes contain a hard drive pre-loaded with songs available for play by customers upon inserting a coin into the jukebox. Taxpayer also allows music to be downloaded via the Internet. Depending on the specific services, some downloads are directly onto the jukebox hard drive, while others are for one-time listening only and are accessed from the operator’s database.

Taxpayer charges for the music already on the hard drive or downloaded via the Internet based on a variety of music service packages. The request letter outlined the various music service packages provided and the charges that Taxpayer collects. The letter also notes that Taxpayer provides technical support service, which is included with the purchase of each jukebox, at no charge to operators.

APPLICABLE LAW

Utah Code Ann. §59-12-103(1) imposes tax on the following transactions, “(a) retail sales of tangible personal property made within the state; (g) amounts paid or charged for services for repairs or renovations of tangible personal property...;(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...”

Section §59-12-102(92) defines tangible personal property to include “(a)...personal property that: (i) may be: (A) seen; (B) weighed; (C) measured; (D) felt; or (E) touched; or (ii) is in any manner perceptible to the senses.” Tangible personal property includes “(b)(v) prewritten computer software.”

Under §59-12-102(73) a repair or renovation as “(a) a repair or renovation of tangible personal property that is not permanently attached to real property; or (b) attaching tangible personal property to other tangible personal property if the other tangible personal property to which the tangible personal property is attached is not permanently attached to real property.”

In addition, Tax Commission Administrative Rule R865-19S-92 states, “(D) The sale of computer generated output is subject to the sales or use tax if the primary object of the sale is the output and not the services rendered in producing the output.”

ANALYSIS

Your letter stated that the actual sale or lease of the electronic jukebox is subject to Utah sales and use tax and the Tax Commission concurs with that statement. The questions raised in the letter refer to the applicability of Utah sales and use tax to the nine different music packages provided by Taxpayer to its customers. Each package is addressed separately below.

However, before specifically addressing the individual packages, we will make a general observation in order to provide some background and a broader context. As stated in your letter, the product you provide to the operators consists essentially of digital musical packages. This music is considered tangible personal property in the form of prewritten computer software or computer generated output. (Rule R865-19S-92) However, a question arises as to whether the charges are for tangible personal property purchased for resale or for consumption by the operator. The Tax Commission previously addressed this issue in Private Letter Ruling 95-010, which dealt with purchases of amusement devices. “The resale exemption...would be applicable if the charges for use of the [amusement] devices constitute charges for the rental or lease of tangible personal property....The fees or charges for the use of the subject amusement devices,

however, are not being taxed for the sale, rental, or lease of tangible personal property.” (Emphasis added) That letter went on further to clarify that “[p]urchases of coin-operated or other amusement devices for the purpose of generating revenue from admissions or use fees are purchases at retail.”

Although that letter corresponds more directly to the treatment of the jukebox itself, we consider the music packages to be similar in that they are part of, or incorporated into, an amusement device (the jukebox). The Tax Commission does not view the transactions as purchases of tangible personal property from Taxpayer, which the operator then resells to its customers. Rather we consider the operator to be purchasing tangible personal property (the digital music packages or downloads) from Taxpayer for the purpose of providing an entertainment service to its customers. Thus the operator is deemed to be consuming tangible personal property in providing this service just as it is consuming the jukeboxes.

With this overview, we now address each of the distinct packages outlined in your request letter.

- A. Fixed Rate, New Fixed Rate, Fixed Rate 2006. For this package, the operator is charged a weekly base fee of \$12.95 plus \$0.04 each time a song is played. A fixed number of free music downloads is included annually.

The amounts you charge these operators for the music that is played on the jukebox are for tangible personal property that is consumed by the operator. These charges are subject to sales tax. The amount subject to tax would be the weekly base fee of \$12.95 plus \$0.04 each time the song is played.

These charges are for the music that is played by the jukebox. This music is considered tangible personal property in the form of prewritten computer software or computer generated output. (Utah Administrative Rule R865-19S-92) However, a question arises as to whether the charges are for tangible personal property purchased for resale or for consumption by the operator. The Tax Commission in Private Letter Ruling 95-010 previously addressed this issue. “The resale exemption... would be applicable if the charges for use of the devices constituted charges for the rental or lease of tangible personal property which are taxable under [Utah Code Section §59-12-102(1)(k)]. The fees or charges for the use of the subject amusement devices, however, are not being taxed for the sale, rental, or lease of tangible personal property.”

These charges are for music that is consumed by the operator of the jukebox and are subject to sales tax. Tax would be due on the operator’s purchase of the songs. The amount subject to tax would be the weekly base fee of \$12.95 plus \$0.04 each time the song is played.

- B. Ultra 16. Here the operator is charged a weekly base fee of \$12.95 plus 16% of the revenue from the total coinage intake. A fixed number of free music downloads is included annually. The answer for this package is the same as A above.

- C. Elite, New Elite, Fixed Percentage Program. In this program there is no base fee. The

operator is charged between 20% and 23% of the total revenue coinage intake. A fixed number of free music downloads is included annually. The answer for this package is the same as A. above.

The following are separately stated charges:

- D. Additional Song Downloads. This is a charge of \$1.50 for each song downloaded after the operator has exceeded its free annual download allotment. This is a charge in the same nature as the above charges and the answer to A is applicable.
- E. F. & G. Tune Central. These three services are interrelated. They differ from the previous services in that the song is not downloaded onto the operator's jukebox hard drive. Instead, within the guidelines of the program purchased, the operator's customer may look for a song that is not currently on the operator's hard drive. This is available if the operator has purchased or leased Tune Central. This provides the customer with access to taxpayer's complete music access database. A song is accessed directly through the jukebox entity and played one time. Taxpayer makes a charge to the operator for this service.

In the past, the Tax Commission has ruled that a charge to simply access a database is not taxable if items are not downloaded onto the customer's computer. However, in this case, even though the item is not downloaded onto the hard drive, it appears that it is downloaded onto the jukebox system for the single play. Because the customer has control of when the song will be played, the charge is like the ones on the above items and is taxable.

- H. Background Music. This is a separate charge for service available with certain of the above packages. The charge is based on a graduated rate based on the percentage of total jukebox plays. Generally, if background music is provided on a piped or satellite system, it has been considered a service and is not taxable. However, it is not clear from the request letter whether the background music is in direct control of the operator so that the operator can change it as it pleases or whether it is preloaded into the jukebox and the operator has no control over it. If background music is controlled directly by the operator, then it is not taxable. Otherwise, taxes are due on the background music.
- I. Telephone Support Services. This provides operators with twenty-four hour telephone support. It also provides exchange of damaged or defective parts and/or any applicable software upgrades and on-site field service technicians. The telephone support is a nontaxable service; however, the parts exchange is a charge for repair of tangible personal property and the software upgrades are purchases of tangible personal property. These are taxable transactions. It is not clear from your letter if the two transactions are separately stated. If the nontaxable and taxable charges are not separately stated, the entire transaction is taxable.

CONCLUSION

Based on the analysis provided above and in line with the facts stated in your request letter, our ruling is as follows:

1. The charges under music service packages A, B and C are subject to sales and use tax;
2. With respect to the separately stated charges D, E, F, and G, sales and use tax are applicable because the charges are in the same nature as packages A, B and C.
3. Depending on the way the background music is provided to the Operator, tax may be due.
4. The telephone support services appear to cover both taxable (exchange of damaged or defective parts and software upgrades) and nontaxable (twenty-four hour telephone support) charges. If the two transactions are not separately stated, the entire transaction is taxable.

Our ruling is based on the facts you presented. Should the facts be different from those represented in this letter, our opinion may change accordingly. Thank you for your inquiry into this matter.

Marc B. Johnson
Commissioner

MBJ/BA
07-002

