FINAL PRIVATE LETTER RULING

REQUEST LETTER

October 31, 2008

Marc B. Johnson, Commissioner
Utah State Tax Commission
Salt Lake City, UT

Dear Mr. Johnson:

NAME is a Certified Service Provider and has solutions that can be implemented as a Certified Automated System in accordance with the standards established and approved by the Streamlined Sales Tax Governing Board. We would like to verify the taxation in your state for the service of an Application Service Provider (ASP). We reviewed Private Letter Rulings 01-027, 07-013 and 08-002 with our client and request guidance on the following.

Corporation A is located outside Utah and provides a service to Utah customers. Corporation A's Utah customers remotely access and use application/software that resides on servers located outside the State of Utah. Utah customers do not receive the software in any tangible medium and do not download the application/software to their hardware located in Utah. No license is granted for access to the application/software.

Questions:
(1) Is the service of Corporation A, which allows Utah customers to remotely access application/software that resides on a remote server owned by the ASP and located outside Utah where the customer receives no tangible medium and does not have the right to download the application/software, subject to sales or use tax in your jurisdiction?

Additional Facts for Questions 2 and 3: Assume the same facts above, however, the contract between the Utah customer and Corporation A grants the customer a license to remotely access and use the application/software. The "license" is in name only and essentially serves as permission to access the database. The contract states "This license is not a sale of the [software] or any right, title or interest therein." The Customer, therefore, does not receive any rights or powers over the software. The customer cannot download the software or modify or change it in any way. The software is a tool of the ASP, as the data is applied through the software, and the customer receives only permission to access the software through the internet to receive the services that it desires.

(2) Is the service of Corporation A subject to sales and use tax in your jurisdiction under the facts set forth in question (1), but where the ASP grants a license to the Customer to remotely access and use the software?

(3) Is the service of Corporation A subject to sales and use tax in your jurisdiction under the facts set forth in question (2) but where the license is specifically granted for no charge or consideration?

Analysis:
Based on our review of your laws and regulations we believe number 1 would not be subject to tax in your jurisdiction and need your guidance on numbers 2 and 3.

Thank you for your assistance in this matter.

Sincerely,
NAME
V.P. Government Relations

2ND NAME
Director of Tax Research

COMPANY

RESPONSE LETTER

January 21, 2009

NAME
2ND NAME

RE: Private Letter Ruling Request—Sales Tax Treatment of Services Provided by Corporation A to Utah Customers.

Dear Mr. NAME and Mr. 2ND NAME:

Your company, COMPANY, has requested a ruling for its client ("Corporation A") as to the sales tax treatment of Corporation A's services involving an Application Service Provider ("ASP"). COMPANY stated that it has reviewed Private Letter Rulings ("PLR's") 01-027, 07-013, and 08-002 with Corporation A. Corporation A is located outside of Utah and provides a service to Utah customers. The Utah customers of Corporation A remotely access and use an application/software that resides on the ASP's servers located outside of Utah. The software is a tool of the COMPANY because data is applied through the software and the customer can only access the software through the internet to receive the service. Utah customers do not receive the software in any tangible medium and do not download the application/software to their hardware located in Utah. For this PLR, COMPANY asks three specific questions. For the first question, no license is granted to the customer for access to the application/software. COMPANY asks:

> (1) Is the service of Corporation A, which allows Utah customers to remotely access application/software that resides on a remote server owned by the COMPANY and located outside Utah where the customer receives no tangible medium and does not have the right to download the application/software, subject to sales or use tax in your jurisdiction?

For the next two questions, COMPANY proposes additional facts in which the COMPANY confers a license to the customer. The license is part of the contract between Corporation A and the Utah customer and grants the customer permission to remotely access and use the application/software. The contract states: "This license is not a sale of the [software] or any right, title or interest therein." COMPANY provides that the customer does not receive any rights or powers over the software and the customer cannot download the software or modify or change it in any way. COMPANY specifically asks:

> (2) Is the service of Corporation A subject to sales and use tax in your jurisdiction when the ASP grants a license to the customer to remotely access and use the software?

and

(3) Is the service of Corporation A subject to sales and use tax in your jurisdiction where the license is specifically granted for no charge or consideration?

Applicable Law

Utah Code Ann. § 59-12-103 imposes a sales tax on certain transactions involving tangible personal property, as set forth below in pertinent part:

(1) A tax is imposed on the purchaser as provided in this part 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. § 59-12-103 (effective January 1, 2009) clarifies through subsection (n) that sales tax is imposed on certain transactions involving products transferred electronically, stating:

(1) A tax is imposed on the purchaser as provided in this part for amounts paid or charged for the following transactions…

(n) amounts paid or charged for a sale:
(i) (A) of a product that:
(I) is transferred electronically; and
(II) would be subject to a tax under this chapter if the product was transferred in a manner other than electronically; or
(B) of a repair or renovation of a product that:
(I) is transferred electronically; and
(II) would be subject to a tax under this chapter if the product was transferred in a manner other than electronically; and
(ii) regardless of whether the sale provides:

(A) a right of permanent use of the product; or
(B) a right to use the product that is less than a permanent use, including a right:
(I) for a definite or specified length of time; and
(II) that terminates upon the occurrence of a condition.

Utah Code Ann. § 59-12-102(97) (effective until January 1, 2009) defines "tangible personal property" to include prewritten computer software, stating:

(a) "Tangible personal property" means 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.

(b) "Tangible personal property" includes:
(i) electricity;
(ii) water;
(iii) gas;
(iv) steam; or
(v) prewritten computer software.

Utah Code Ann. § 59-12-102(108) (effective January 1, 2009) modifies "tangible personal property" to exclude a product transferred electronically. Subsection (c) provides:

(c) "Tangible personal property" does not include a product that is transferred electronically.

Therefore under § 59-12-102(108) (effective January 1, 2009), prewritten computer software that is transferred electronically will be excluded from "tangible personal property" and no longer taxed under §59-12-103(1)(a), (k) and (l). Rather, prewritten computer software that is transferred electronically will be taxed under § 59-12-103(1)(n) as a product transferred electronically.

Utah Code Ann. § 59-12-102(83) (effective until January 1, 2009) and § 59-12-102(94) (effective January 1, 2009) define "sale," as set forth below:

(a) "Sale" means any transfer of title, exchange, or barter, conditional or otherwise, in any manner, of tangible personal property or any other taxable transaction under Subsection 59-12-103(1), for consideration.

(b) "Sale" includes:
  (i) installment and credit sales;
  (ii) any closed transaction constituting a sale;
  (iii) any sale of electrical energy, gas, services, or entertainment taxable under this chapter;
  (iv) any transaction if the possession of property is transferred but the seller retains the title as security for the payment of the price; and
  (v) any transaction under which right to possession, operation, or use of any article of tangible personal property is granted under a lease or contract and the transfer of possession would be taxable if an outright sale were made.

Utah Code Ann. § 59-12-102(68) (effective until January 1, 2009) and § 59-12-102(77) (effective January 1, 2009) define "prewritten computer software" as follows:

(a) Except as provide in Subsection (68)(b)(ii) or (iii), "prewritten computer software" means computer software that is not designed and developed:
  (i) by the author or other creator of the computer software; and
  (ii) to the specifications of a specific purchaser.

Prewritten software is further defined in subsections (b) and (c) of § 59-12-102(68) and in Utah Admin. Code R865-19S-92. However, whether the software is prewritten is not at issue in this case.

Utah Admin. Code R865-19S-92(B) ("Rule 92B") provides:

> The sale, rental or lease of prewritten computer software constitutes a sale of tangible personal property and is subject to the sales or use tax regardless of the form in which the software is purchased or transferred.

Under Rule 92B, the form in which the software is purchased or transferred is irrelevant.

PLR's 07-013, 01-027, and 08-002 analyze the sales tax treatment of transactions involving computer software. In PLR 07-013, a Utah company provided customers with a backup and recovery service. Connected with this service, the company provided its customers with prewritten computer software that allowed the customers to select the files to be backed up and to set certain parameters. The software was useless without the backup service. To provide this service, the company temporarily stored the customers' files on the company's servers. The Commission found that, under the primary object or essence of the transaction test, the company was primarily providing a backup service, not a product. Likewise, the Commission found that the software was merely incidental to providing the backup service and that the software was consumed by the company. Furthermore, the Commission found that the company's servers were not leased to its customers because the true object of the transaction for the customers was not the acquisition of storage space. The servers were not necessary for the customers to conduct all of their normal operations.

In PLR 01-027, a company sold licenses to its content software and its content database. The Commission found that the content software and content database were prewritten computer software. If that software was delivered by disk or electronic means to a Utah customer such that the customer possessed the software or the software resided on the customer's computer, then that software was taxable. If a customer merely viewed a database without downloading it, the customer was not in possession of the software. Additionally, a customer would possess the software if the software was downloaded onto a server located in Utah and the customer was considered to be renting or leasing that server. If the server were located outside of Utah, the customer would not possess the software in Utah and the sale of the software would not be taxable in Utah.

In PLR 08-002, a Utah corporation provided its customers with the use of prewritten computer software that resided on the corporation's servers located in Utah. The corporation charged a Base Service fee for the customers' right to use the prewritten software and for the Corporation's commitment to maintain, backup, and provide the customers continuous access to the base software and the customers' databases on the corporation's servers. The Commission found that the customers leased the corporations' servers, stating:

> [The corporation's] customers create databases using the [] software. These databases are stored on servers maintained by [the corporation], and located in the State of Utah. While the customers are not allocated a specific server, or portion of that server, the Commission has previously determined that such circumstances constitute a lease of tangible personal property. Therefore, the Commission finds that the hosting of the software and customer databases by [the corporation] is also taxable as a "lease" or "rental" of server space.

The Commission also found that the corporation sold the prewritten computer software to the customers, stating:

> There is no doubt that [the corporation]'s customer received the "right to…use of [an] article of tangible personal property" under their contracts. Similarly, there seems to be no question that if the customer took possession of the software and utilized it on their server, it would be a taxable transaction as the sale of tangible personal property.

Therefore, the Commission found that the Base Service fee charged by the Utah corporation for the customers' use of the software on the servers in Utah was subject to Utah sales tax.

Analysis

As explained below, Corporation A's services, as described in this PLR, are not subject to Utah sales tax, regardless of whether the ASP merely provides Utah customers with remote access to the application /software on the server located out of state or the ASP additionally grants a license to the Utah customers giving permission for remote access to the software on the server located out of state.

In the current situation, Corporation A is primarily providing access to and use of the prewritten computer software located on the ASP servers. The software involved is not merely incidental to the services of Corporation A. PLR 07-013 does not apply because it is distinguishable from the present situation. In PLR 07-013, the Commission found that the primary object or essence of the transaction was to provide a backup service, not to provide the software. In the current situation, the primary object or essence is to provide the software. [1]

Utah law imposes a sales tax on the sale of tangible personal property made within the state. *See* § 59-12-103 (1)(a), (k) and (l). Also, Utah law imposes a sales tax on the sale of a product that is transferred electronically if that product would have been subject to tax had that product been transferred in a manner other than electronically. *See* § 59-12-103(1)(n)(effective January 1, 2009). Before January 1, 2009, prewritten computer software transferred electronically was included in the definition of tangible personal property (*see* §59-12-102(97) (effective until January 1, 2009)) and was taxable under § 59-12-103 (1)(a), (k), and (l). After January 1, 2009, prewritten computer software transferred electronically will be excluded from the definition of tangible personal property (*see* § 59-12-102(108)(c) (effective January 1, 2009)) and will be taxable under § 59-12-103(1)(n). Basically, the tax treatment of prewritten computer software transferred electronically remains the same both before and after January 1, 2009; a sale of such is subject to tax if the sale is made within the state. In this case, Corporation A sold computer software transferred electronically, which sales may be taxable by Utah if the sales were made within Utah.

By definition, prewritten computer software is not designed and developed by the author "to the specifications of a specific purchaser." *See* §59-12-102(68) (effective until January 1, 2009) and § 59-12-102(77) (effective January 1, 2009). In this case, the software is very likely to be prewritten; no facts suggest otherwise.

"Sale" is defined as "any transfer of title, exchange, or barter, conditional or otherwise, in any manner, of tangible personal property or any other taxable transaction under Subsection 59-12-103(1), for consideration." Utah Code Ann. § 59-12-102(83) (effective until January 1, 2009) and § 59-12-102(94) (effective January 1, 2009). Furthermore, a "sale" specifically includes "any transaction under which right to possession, operation, or use of any article of tangible personal property is granted under a lease or contract and the transfer of possession would be taxable if an outright sale were made." Under Rule 92B, "[t]he sale, rental or lease of prewritten computer software . . . is subject to the sales or use tax regardless of the form in which the software is purchased or transferred." In this case, Corporation A sold the prewritten computer software because the customers received the "right to…use of [an] article of tangible personal property" under their contracts. In your request letter, you provide that "[t]he Utah customers of

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1 On the other hand, if the primary object of the transaction of Corporation A is to offer services other than providing access to the software and if the software is just a tool of the ASP, then PLR 07-013 may apply. In PLR 07-013, the software provider was the consumer of the software, not the customers. Likewise if the software were just a tool of the ASP, then the ASP would be the consumer of the software, not Corporation A or its Utah customers. Additionally, the ASP would be consuming that software out of state, on its servers located outside of Utah, so the software would not be subject to Utah sales tax.

Corporation A remotely access and use an application/software that resides on the ASP's servers . . ." The main issue for this PLR is whether the sale of the prewritten computer software occurs in Utah.

PLR's 01-027 and 08-002 discuss situations in which customers remotely access and use an application or software. In PLR 01-027, the Commission advised that a customer would possess prewritten computer software if the software were downloaded and at least temporarily resided on the customer's computer. The customer would not possess the software if the "customer goes to an Internet site to view a database without downloading the []software [] on his or her own computer . . ." It is clear from this statement that the mere viewing of a program or database without downloading does not create possession. However, the customer would possess the software if it were downloaded onto a server that the customer was considered to be renting or leasing. If that server was located in Utah, then the customer would possess the software in Utah and the sale of the software would be taxable by Utah. If the server were not in Utah, then the transaction would not be taxable by Utah. The logic of PLR 01-027 is consistent with PLR 08-002. In PLR 08-002, for a Base Service fee, the corporation sold the remote use of its prewritten computer software on its servers located in Utah, the corporation promised to provide customers continuous access to those servers, and the corporation to provided related backup and maintenance services for the customers' files. In that case, the Commission found that the sale of the prewritten software and use of the servers were taxable by Utah.

In this present situation, similar to PLR's 01-027 and 08-002, Corporation A sells the prewritten computer software, which its customers access remotely. Following the logic of PLR 01-027, Corporation A's customers possess the software when the software is downloaded onto the ASP server, which the customers are leasing. However, because the ASP's server is not located in Utah, the customers do not possess the software in Utah and the sales transactions are not taxable by Utah. The customers' remote access of the software without downloading the software onto a computer located in Utah does not create possession of the software in Utah. Instead, such access is akin to merely going to an internet site and viewing a database without downloading the software, as discussed in PLR 01-027. PLR 08-002 is clearly distinguishable from the present case because the servers for PLR 08-002 were located in Utah while the service in this case is not. In PLR 08-002, because the servers with the software were located in Utah, the Base Service fee was taxable. In the present case, because the server is located outside of Utah, Corporation A's services are not taxable by Utah. Basically, this factual difference of the servers' locations throws the current situation outside the imposition of the tax that occurred in PLR 08-002.

The taxability of the software on the ASP's servers would not change regardless of whether the ASP grants a license. There is no difference as long as the software is not transferred or downloaded onto the customer's hardware located in Utah.

Conclusion

Based on the above analysis, Corporation A's services that involve granting access to the software located on the ASP's server located outside of Utah are not subject to Utah sales tax. Our conclusions are based on the facts as described. Should the facts be different, a different

conclusion may be warranted. If you feel we have misunderstood the facts as you have presented them, if you have additional facts that may be relevant, or if you have any other questions, please contact us.

For the Commission,

Marc B. Johnson
Commissioner

MBJ/aln
08-012