



Opinion of the Tax Commissioner

Date Issued: February 4, 2014

Opinion No: 14-0001

Tax: Sales and Use

XXXX
XXXX
XXXX

Subject: Cloud-based Applications

This request for an Opinion of the Tax Commissioner was received on February 25, 2013. It concerns the application of sales tax to cloud-based software.

FACTS

In your letter you provided the following facts:

XXXX is a leading multi-brand technology solutions provider to business, government, education and healthcare customers in the U.S. and Canada, providing comprehensive and integrated solutions for its customers' technology needs through its extensive hardware, software and value-added service offerings. XXXX offers over 100,000 products from over 1,000 brands and a multitude of advanced technology solutions. Its offerings range from discrete hardware and software products to complex technology solutions such as virtualization, collaboration, security, mobility, data center optimization, and cloud computing.

As described in more detail below, XXXX offers a cloud-based service offering (the "Cloud Collaboration Service Offering" or the "Offering") to customers nationwide. The Cloud Collaboration Service Offering will provide certain cloud-based applications and related services (the "Cloud Collaboration Services" or the "Services") that support a customer's telecommunication equipment, including its voice, video, messaging, presence, audio, web conferencing, and mobile capabilities. This Letter specifically requests a ruling concerning the applicability of sales and use taxes in your state to the Cloud Collaboration Service Offering.

Overview of the Cloud Collaboration Service Offering

Generally, a business's phone systems, computers and other telecommunications equipment utilize various software applications and hardware in order to operate and function in the manner necessary for the business's needs. For instance, although a business may have a telecommunications provider that provides it with telephone lines to make outgoing and receive incoming calls, the business will need hardware and software that internally instructs the business's telecommunications equipment as to how to process and route those calls. Historically, customers have handled these functions internally, and such functions have not been subject to sales tax. Through the Cloud Collaboration Service Offering,

XXXX will simply be providing these non-taxable functions as a service to its customers from an offsite location.

Specifically, the Cloud Collaboration Service Offering replaces certain customer-owned and maintained software applications and related computer hardware that support a customer's telecommunications equipment with a XXXX-hosted alternative. In this hosted alternative, XXXX owns (or is the lessee or licensee of) and maintains certain hardware and software. The benefit of the Cloud Collaboration Service Offering is that customers can utilize the hardware and software cloud applications on an as-needed basis from XXXX, thereby reducing the customer's capital investment and on-going technology support and maintenance expenditures for such systems. The customer utilizes the hosted applications by means of the customer's existing telecommunications, Internet, or network connections, for which it pays its own third party telecommunications provider. In essence, in exchange for a monthly fee, XXXX will operate back-office equipment and software applications that provide necessary or enhanced functionality for a customer's phone systems and other telecommunication equipment. The customer will provide the telecommunications equipment.

XXXX will acquire, operate and maintain all the hardware and software necessary to provide the Services and ensure optimal performance. The hardware and software required for providing the Services will be installed on servers located outside Ohio. XXXX employees based outside Ohio will provide onsite professional services to maintain the hardware and software, and XXXX employees based outside Ohio will remotely monitor performance, perform necessary adds, moves, changes, and deletions, and provide troubleshooting for issues that arise during performance.

The Manner in Which the Services Are Provided

The Services will be provided by XXXX on a remote basis through the use of XXXX-owned clusters located at a XXXX data center. The clusters will deploy a variety of available XXXX-owned, client software applications that are utilized by customer-owned phones and workstations located at customer sites. As described further below, the applications generally provide the customer's telecommunication equipment with certain necessary or enhanced functionalities.

Customers will be responsible for providing connectivity of sufficient bandwidth between the customer's location and XXXX's data center. XXXX relies on the customer's QoS-enabled, voice-grade Local Area Network and Wide Area Network over which it provides the Services throughout a customer's geographic locations. Connectivity to the Public Switched Telephone Network ("PSIN") is not included in the Cloud Collaboration Service Offering. All connections between the customer and XXXX's data center are through a customer's existing or newly-ordered PSTN circuits, phone lines and Internet connections. The PSTN or other connections can reside throughout the customer locations, and are terminated into the XXXX data center through customer-owned, XXXX-managed gateways. Customers are always the "customer of record" for any PSTN, Internet or other service for the transportation or transmission of messages or information; the applications do not transport or transmit messages or information. All customer communications with third parties are through customer-contracted PSTN connections that are not provided by

XXXX. XXXX's customers continue to communicate with third parties over the PSIN, and continue to pay their telecommunications provider the same charges and taxes for such capabilities, both before and after signing up for the XXXX Cloud Collaboration Service Offering. PSTN communications with third parties are never physically routed through XXXX's data center equipment.

XXXX may also host and deploy certain customer-owned software applications that provide enhanced functionalities for a customer's phone systems and other telecommunication equipment. Such hosted services are available as add-on services for additional fees (as described below), and are utilized by customers in the same manner as the XXXX-owned and hosted software applications.

Agreements and Monthly Charges

To purchase the Cloud Collaboration Service Offering, customers will enter into a contract with XXXX that includes a customer service order, a service description for the Offering, and a detailed pricing invoice.

Under the contract with a customer, XXXX will charge the customer a monthly user license fee, calculated based on the number of users. The monthly fee covers the charges for hardware, software, virtual server instance charges, required storage charges, rack space charges, power and cooling charges, as well as monitoring and management charges, most moves-adds changes and major version upgrades. To the extent the customer purchases add-on services (including the hosting of customer-owned software applications), separate fees are charged for each such service. Charges for maintenance and management of any customer-owned software applications are also separately stated on the monthly invoice.

Description of the Services Provided by the Embedded Software Applications

As described above, the XXXX-owned software applications available through the Offering support a customer's own voice, video, messaging, presence, audio/web conferencing, and mobile capabilities. A brief description of the supporting services provided by the various applications is set forth below:

Voice. A XXXX server, utilizing the cluster, communicates with the customer's voice gateway device (*i.e.*, the customer-owned switch) to provide instructions to the customer's voice gateway device for the processing and routing of incoming and outgoing calls among the customer's phone extensions; the call is not routed through XXXX's server. No end-to-end communication is ever routed through XXXX's server. This system also supports a customer's other forms of communication to its IP endpoints, media-processing devices, VoIP gateways, mobile devices, and multimedia applications, as generally described below.

Video. Video is the technology of electronically capturing, recording, processing, storing, transmitting, and reconstructing a sequence of still images representing scenes in motion. The video support services will be provided by XXXX's server through a cluster in the same manner as outlined above with respect to a customer's voice communication capabilities.

Messaging When a customer phone extension does not answer an incoming call, the XXXX server, utilizing the cluster, instructs the customer's voice gateway device to send the call to voicemail. The voice messages are then stored on the XXXX servers and available for the user to access and manage at his or her convenience. The voice messaging support services provided by the Cloud Collaboration Service Offering will allow users to access and manage voice messages stored on XXXX-owned servers in a variety of ways, using an email inbox, web browser, or other components.

Presence. Presence support services are provided by XXXX through an application that provides users the ability to determine when colleagues are available. The 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. As is the case with respect to the other services, the customer's own communications equipment accesses the application hosted on XXXX's servers to utilize the presence capabilities.

Audio Conferencing. With respect to a customer's audio conferencing capabilities, XXXX supports a customer-owned router and the phone devices through its hosted cluster, in a manner similar to that which is described above with respect to the voice support services.

Web Conferencing. XXXX application is an optional, subscription-based component of the Offering. This cloud-based web conferencing application permits desktop sharing through a web browser with phone conferencing and video. XXXX operates through a user's computer or wireless device, an audio connection (either through the computer or through a phone), and a webcam (optional).

Mobility Services. XXXX supports a customer's mobile devices through use of the application. Mobile clients utilizing an application can place and receive calls over their own corporate wireless local area network and telephony infrastructure, using XXXX's server to instruct the routing of calls, and essentially turns a mobile phone into another extension on the cluster. XXXX's server itself does not provide the routing for the call or otherwise function as a switch. No end-to-end communication is ever routed through XXXX's server.

With respect to each of the support services described above, a customer utilizes the XXXX-owned and hosted software with its own equipment and through its own telecommunication, Internet or other network connection. At no time does the customer download or otherwise possess the software that is hosted by XXXX. In addition, XXXX does not provide the telecommunication, Internet or network connections necessary for the customer to utilize the Services. The net result is that the customer has done nothing more than out-source certain activities previously performed in-house that were never subject to sales tax.

REQUESTED OPINION

Given the above facts, you requested the following Opinion of the Tax Commissioner:

1. The hardware and software that XXXX purchases, leases or licenses from third parties is purchased, leased or licensed by XXXX for use or consumption and not for resale.
2. The Services provided by the Cloud Collaboration Service Offering are nontaxable services and not a lease or license of hardware or software.
3. Alternatively, if it is determined that the Cloud Collaboration Service Offering constitutes a lease, license or other transfer of software to a customer, such transfer is exempt from tax as electronically delivered software.
4. The Services provided by the Cloud Collaboration Service Offering are not taxable telecommunications services.
5. For sales and use tax purposes, the Services provided by the Cloud Collaboration Service Offering are provided in Illinois.

APPLICABLE LAW

R.C. 5739.02 levies an excise tax on each retail sale made in Ohio. R.C. 5739.01(B)(1) defines “sale” for Ohio sales and use tax purposes to include any transfer of title, possession, or a right to use tangible personal property in Ohio and certain enumerated services. One of the services designated as taxable in Ohio is “automatic data processing,” when used in business. R. C. 5739.01(B)(3)(e). R.C. 5739.01(Y)(1)(a) defines automatic data processing as follows:

“Automatic data processing” means processing of others’ data, including keypunching or similar data entry services together with verification thereof, or providing access to computer equipment for the purpose of processing data.

Another taxable service is “electronic information services” when used in business. R. C. 5739.01(B)(3)(e). This service is defined in R.C. 5739.01(Y)(1)(c) as follows:

"Electronic information services" means providing access to computer equipment by means of telecommunications equipment for the purpose of either of the following:

- (i) Examining or acquiring data stored in or accessible to the computer equipment;
- (ii) Placing data into the computer equipment to be retrieved by designated recipients with access to the computer equipment.

Electronic information services do not include personal or professional services. Electronic information services are sourced to Ohio if the consumer receives the benefit of the service in Ohio. See R.C. 5739.033. In other words, if the consumer is located in Ohio and accesses the electronic information service in Ohio, the transaction is a taxable Ohio sale.

R.C. 5739.033(D)(1)(a) permits a business consumer that purchases a service who knows at the time of purchase that such service will be concurrently available for use in more than one taxing jurisdiction to provide the vendor an exemption certificate claiming multiple points of use. Upon receipt of the multiple points of use exemption certificate, the vendor is relieved of its obligation to collect and remit the sales tax due as the subscriber must pay the use tax directly to Ohio

DISCUSSION

The Cloud Collaboration Service Offering provides the customer with hosted software applications via access to XXXX-owned computer hardware to support the customers' telecommunications equipment. Therefore, the Cloud Collaboration Service Offering is taxable as an automatic data processing service because XXXX is providing its customers access to computer equipment so that the customer can process data. The charges for hosting services are part of the tax base as they are charges for services necessary to complete the sale and are part of the taxable price under R.C. 5739.01(H).

The Cloud Collaboration Service Offering is taxable in Ohio if XXXX's customer receives the benefit of the service in Ohio, i.e., customer is located in Ohio and accesses the service from their location in Ohio. If the customer will be using the service in multiple locations and provides XXXX with a multiple points of use exemption certificate, XXXX is relieved of its obligation to collect and remit Ohio sales tax on the service.

OPINION OF THE TAX COMMISSIONER

Therefore, it is the Opinion of the Tax Commissioner that:

1. The software and hardware used to provide the Cloud Collaboration Service Offering is located outside of Ohio. As such, it is not used in Ohio and is not subject to Ohio use tax.
2. The Offering is taxable as an automatic data processing service, if used in business. The charge for hosting services is taxable as part of the price of the automatic data processing service.
3. The Offering is taxable in Ohio if the benefit of the service is received in Ohio. The benefit of the service is received in Ohio if the customer is located in Ohio and accesses the service from their location in Ohio.

This Opinion is limited to the legal issue addressed in this Opinion. This Opinion applies only to this Taxpayer and may not be transferred or assigned. In addition, the tax consequences stated in this Opinion may be subject to change for any of the reasons stated in R.C. 5703.53(C). It is the duty of Taxpayer to be aware of such changes. See R.C. 5703.53(E).

Joseph W. Testa
Tax Commissioner