FINAL PRIVATE LETTER RULING

REQUEST LETTER

February 13, 2009

09-003

NAME
COMPANY
ADDRESS

Dear Sir or Madam:

On behalf of our client, which is referred to throughout this letter as "Company", we hereby respectfully request a private letter ruling from the Utah State Tax Commission (the "Commission") regarding the application of Utah sales/use tax to the transaction described below. Due to the fact Company's quarter-end will close on April 30, 2009, and Company must take into account the Commission's ruling of its financial reporting purposes, Company kindly requests the Commission to review this letter request on an expedited basis and issue a private letter ruling on or before April 15, 2009. However, if a formal written ruling cannot be issued by this date, we would be most grateful to receive an informal response, via phone or e-mail, regarding the Commission's conclusion, followed by a formal ruling at a later date, reflecting the conclusion provided in the informal response.

As set forth in more detail below, Company has been prompted to seek the Commission's ruling due to the issuance of Private Letter Ruling 08-002 on August 4, 2008. Pursuant to the specific request set forth herein, at this time Company is asking the Commission to address the sales/use tax treatment for only those transactions occurring on or before December 31, 2008.

Please note that we are aware of the many legislative and regulatory changes that became effective on January 1, 2009. In light of these changes, we expect to submit on behalf of Company a second request to the Commission to address the treatment of Company's transactions occurring on or after January 1, 2009.

Company specifically requests the following rulings:

1. For transactions occurring on or before December 31, 2008:

   1(a). Pursuant to Private Letter Ruling 08-002, issued August 4, 2008, and relevant statues and regulations, Company's Subscription Fee (as defined below) is not subject to Utah sales/use tax.

1(b). To the extent the Commission determines the Subscription Fee is subject to Utah sales/use tax, such determination is applicable only for transactions occurring on or after August 4, 2008.[1]

I. I. Facts

B. A. The "Software-as-a Service" Model

Company, a STATE corporation based in 2[ND] STATE, engages in business as what is commonly referred to as a "Software-as-a-Service" (SaaS") provider. A SaaS provider is essentially the same as what is commonly known as an "application service provider" ("ASP"). Specifically, company provides to its client businesses a comprehensive array of on-demand[2] customer relationship management ("CRM") application services through what is referred to as a "SaaS model."

Under a SaaS model, the application software (i.e., the software utilized in providing the CRM application services) resides on the SaaS provider's server and is accessed by users via the Internet. Users cannot install, download or transfer the application software to their own computers. The SaaS provider fully owns and operates the software applications. In addition, the SaaS provider owns (or leases) and maintains the servers that support the application software. Typically the SaaS provider charges customers for accessing its application software based on either usage or a monthly/annual fee.

B. Company's CRM Application Services

Company provides access to its CRM application services on a subscription basis. Clients pay company a monthly fee to obtain unique user accounts for use by their employees and other authorized users (the "Subscription Fee"). Company sends invoices for the monthly Subscription Fees to each client's headquarter location, however, the employees or other authorized users accessing the service may be located in various states or foreign countries.

Company's application services support the four key functional areas within CRM: (i) sales (ii) marketing (iii) customer service/support, and (iv) partner-relationship management. Company also provides a set of on-demand application programming interfaces that clients can use to build and deploy their own custom applications. Clients can customize and integrate the CRM

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1 As discussed in more detail below, Company believes that a determination of taxability should not pre-date this issuance of Private Letter Ruling 08-002 due to the fact its holding appears to be directly contrary to the Commission's former position in Private Letter Rulings 01-027 and 01-030 in which the Commission stated that the use of software is not a taxable transaction where the software is not downloaded by or delivered to the customer. Company has relied on the holdings of these rulings pursuant to which its Subscription Fee was not viewed by the Commission as a taxable transaction.

2 Application services offered by SaaS providers and ASP are often referred to as "on-demand" applications.

application with other software applications, such as the client's existing third-party custom or legacy applications. Company currently does not charge for the use of application programming interfaces. No software related to the application programming interfaces is downloaded by the client.

Clients can access most of Company's application software by using a standard web browser and a password. Clients are prohibited from modifying, copying or making derivative works of company's application software. Company systems are currently hosted on servers located in 2ND STATE and 3RD STATE.[3]

Company is not an Internet service provider and does not provide the Internet connection needed to access the CRM application services; nor does Company host or design websites for its clients.

Company employs approximately six individuals in Utah, all of whom work out of homes offices; Company does not maintain a central office or place of business in Utah. These Utah employees engage in marketing and sales-related activities on behalf of Company, however, such employees do *not* have the authority to enter into sales agreements on behalf of Company. All of Company's sales contracts with Utah Clients are approved and executed at Company's headquarters in 2ND STATE.

III. II. Issues

A. Transactions Occurring On or Before December 31, 2008:

A.1 Whether the Subscription Fee is subject to Utah sales/use tax pursuant to Private Letter Ruling 08-002, August 4, 2008, and relevant statues and regulations.

A.2 To the extent the Commission determines the Subscription Fee is subject to Utah sales/use tax, whether such determination is applicable only for transactions occurring on or after August 4, 2008.

III. Conclusions

A. Transactions Occurring On or Before December 31, 2008:

A.1 The Subscription Fee is not subject to Utah sales/use tax pursuant to Private Letter Ruling 08-002, dated August 3, 2008, and relevant statutes and regulations.

A.2 To the extent the Commission determines the Subscription Fee is subject to Utah sales/use tax, such determination should be applicable only for transactions occurring on or after August 4, 2008.

3 Company has paid sales tax on the purchase or lease of these servers.

IV. Analysis

A. Transactions Occurring On or Before December 31, 2008

1. The Subscription Fee is not subject to Utah sales/use tax pursuant to Private Letter Ruling 08-002, dated August 4, 2008, and relevant statues and regulations.

The Commission issued a Private Letter Ruling on August 4, 2008, published as Opinion No. 08-002 ("Ruling 08-002") addressing the Utah sales tax treatment of specific transactions of a taxpayer that is an ASP. The taxpayer in Ruling 08-002 had very similar facts to Company regarding the way it conducted its business under an ASP model which, as discussed above, is essentially identical to a SaaS model. However, as discussed in more detail below, one key distinction is that the taxpayer in Ruling 08-002 maintained its servers in Utah, whereas company does not have any servers located in Utah. We discuss the details of Ruling 08-002 here as it is relevant to the analysis of company's Subscription Fee.

a. Background of Ruling 08-002

As noted, the taxpayer in Ruling 08-002 ("Taxpayer") is an ASP and offers software-supported service for automobile dealerships that helps automate the dealerships' sales, parts, inventory, and other functions. In connection with its application services, Taxpayer offers to its customers other related support such as phone and Internet support, training, forms programming, data conversion and other services.

Taxpayer's customers are serviced through one of two relationship models: (a) the application service provider model (the "ASP Model"), and (b) the stand-alone model ("Stand Alone Model"). The vast majority of Taxpayer's customers utilize the ASP Model.

i. ASP Model

Under the ASP Model, Taxpayer provides what is referred to as the "Base Service". The software supporting the Base Service (i.e., the base software), resides on servers located in Utah that are leased and maintained by Taxpayer. The Base service includes (a) a nontransferable right to use the base software to access the database containing that customer's data and modify such data, and (b) a commitment by Taxpayer to maintain its servers and provide the customer continuous access to the base software and database during the term of the agreement. Customers access the base software and data files via the Internet. At no time does the base software ever reside on servers that are owned, leased or otherwise maintained by the customers, and the customers using the ASP Model do not have the right to take possession of the base software. Taxpayer does not dedicate specific servers or allocate server space to specific customers. Taxpayer retains complete control of the servers including where and how the customer data is hosted and stored; the customers do not have the ability to add, delete, or otherwise modify the files stored on the servers other than through their use of the Base Service.

At the time of ordering the Base Service, customers require set up of, and training on, the Base Service. Taxpayer charges ASP Model customers a one-time "Set Up" fee, which includes preparing, configuring and setting up the customer's data files on a Taxpayer server. Customers are also charged a one-time "Training" fee, which also includes the out-of-pocket costs for travel, lodging, and meals incurred by Taxpayer staff while on-site training customers to use the Base Service.

In addition to the one-time fees described above, Taxpayer charges its ASP Model customers an Application Service Fee and, if requested, a Support Fee, as follows:

(i) Application Service Fee: This fee is charged in exchange for access to (via the Internet) and use of the base software for the Base Service. This fee also covers a commitment by Taxpayer to maintain, and provide ongoing access to, servers hosting the base software and the customer databases and for any updates for the base software.

(ii) Support Fee: If requested, this fee covers 24-hour/7-days-a-week Internet and phone support for the Base Service and any other services a customer may be receiving from Taxpayer.

ii. Stand Alone Model

Under the Stand Alone Model, a run-only version of software is installed on a server that is owned and maintained by the customer. These customers remit monthly fees (characterized as license fees by the Commission) for software updates and support.

iii. Taxpayer's Ruling Request

As stated by Taxpayer, it requested a ruling from the Commission as follows:

(i) Other than fees from hardware sales, none of the fees from the ASP Model transactions described above are subject to Utah sales tax;

(ii) If it is determined that fees related to the Base Service (or other services) are subject to Utah's sales tax, the Support Fee is not subject to Utah's sales tax; and

(iii) With respect to the stand-alone transactions, only the maintenance fees and hardware sales to customers physically located in the State of Utah are subject to Utah sales tax.

iv. Relevant Authority

The Commission cited to the following provisions of Chapter 12 Sales and Use Taxes of the Utah Code and the Utah Administrative Code rules set forth below *in relevant part.*

Utah Code Ann. §59-12-103 imposes a sales tax on certain transactions, as set forth in 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…
(1) amounts paid or charged for tangible personal property if within this state the tangible property is:
(i) stored;
(ii) used; or
(iii) consumed…

Utah Code Ann. §59-102(97) defines "tangible personal property" to include the following:
(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:
(v) prewritten computer software.

Utah Code Ann. §59-12-102(83) defines "sale", as set forth below, in part:
(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 59-2-103(1), for consideration.
(b) "Sale" includes:
(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) defines "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.
(b) "Prewritten computer software" includes:
(i) a prewritten upgrade to the computer software if the prewritten upgrade to the computer software is not designed and developed:
(A) by the author or other creator of the computer software; and
(B) to the specifications of a specific purchaser;
(ii) notwithstanding Subsection 68(a), computer software designed and developed by the author or other creator of the computer software to the specifications of a specific purchaser if the computer software is sold to a person other than the purchaser; or
(iii) notwithstanding Subsection (68)(a) and except as provide in Subsection (68)(c), prewritten computer software or a prewritten portion of prewritten computer software:
(A) that is modified or enhanced to any degree; and

(B) if the modification or enhancement described in Subsection (68)(b)(iii) (A) is designed and developed to the specifications of a specific purchaser.

(c) Notwithstanding Subsection (68)(b)(iii), "prewritten computer software" does not include a modification or enhancement described in Subsection (68)(b)(iii) if the charges for the modification or enhancement are:
  (i) reasonable; and
  (ii) separately stated on the invoice or other statement of price provided by the purchaser.

Utah Admin Code R865-19S-92 further explains the treatment of computer software and related transactions, set forth below:

A. "Computer-generated output" means the microfiche, microfilm, paper, discs, tapes, molds, or other tangible personal property generated by a computer.
B. 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.
C. The sale, rental or lease of custom computer software constitutes a sale of personal services and is exempt from the sales or use tax, regardless of the form in which the software is purchased or transferred. Charges for services such as software maintenance, consultation in connection with a sale or lease, enhancements, or upgrading of custom software are not taxable.
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.

b. The Commission's Conclusion and Analysis in Ruling 08-002

i. Conclusion

The Commission determined that the following transactions are subject to Utah sales tax:

(1) Base Service under the ASP Model;
(2) Set Up Fee;
(3) Application Service Fee for ASP Model customers; and
(4) Monthly licensing fee for Stand Alone Model customers.

ii. Analysis

(a) <u>ASP Model</u>

The Commission's analysis first addressed the ASP Model and concluded that the contract for Base Service is a taxable "sale" of tangible personal property.

Utah law imposes a sales tax on the sale, lease, or rental of tangible personal property made within the state.[4] Pursuant to this rule of law, the Commission started its analysis by applying a "primary object" test and next looked to the definition of tangible personal property.

In applying the primary object test, the Commission concluded that Taxpayer customers are primarily purchasing a non-transferable right to use software (i.e., the base software), or a software license. The Commission concluded that the services provided by Taxpayer are incidental to the software license, as customers cannot purchase the services without the software license.

As the statutory[5] definition of tangible personal property specifically includes "pre-written computer software"[6] the Commission concluded that "the contract for the Base Service software is essentially a personal property transaction."

The Commission next addressed Taxpayer's contention that the ASP Model is not taxable because it does not include any form of sale, lease, or rental of the base software or any servers.

The Commission concurred that the Base Service is not taxable as a "lease or rental" because there is no transfer of possession or control of the software. However, the Commission disagreed with Taxpayer's assertion that, because title to the base software does not pass to the customers, there is no "sale" of the base software.

In rejecting Taxpayer's argument that no "sale" transpires, the Commission pointed to Utah Code Ann. §59-12-102(83) which defines a sale 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." Further, 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." (Emphasis added.) The Commission stated that customers receive the "right to…use of [an] article of tangible personal property" under their contracts and thus found that "the Base Service is a taxable 'sale'." The Commission also reasoned that this result is the correct answer as the outright sale and/or transfer of possession of the canned software, as is the case with the Stand Alone Model, would be a taxable sale. Specifically, the Commission stated: "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. In fact, this is the circumstance of the Stand Alone Model, to which there is no question that the transaction is subject to sales tax."

The Commission went on to address the specific question of whether there is a "lease or rental" of the servers on which the base software and customer data is hosted. Despite the fact that customers are not allocated a specific server, or specific portion of any server, the Commission considered this to be the lease of disc space and server equipment and hardware and, therefore "this transaction is taxable as a lease of tangible personal property."

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4 Utah Code Ann. §59-12-103.

5 See Utah Code Ann. §59-12-102(97).

6 Note that Taxpayer acknowledged in its request letter that the software was prewritten computer software.

Next, the Commission concluded that the one-time Set Up and Training Fees are subject to Utah sales tax, regardless of where the customer is located, pointing to *Utah Code Ann. §59-12-102(72*) for support, which provides that amounts to be included in the taxable "purchase price" or "sales price" are charges by the seller for any service necessary to complete the sale.

The Commission also concluded that the Application Service Fees are subject to Utah sales tax, regardless of where the customer is located, citing to *Utah Admin. Code R865-19S-92(C)*[7], which provides, "[c]harges for services such as software maintenance, consultation in connection with a sale or lease, enhancements, or upgrading of *custom* software are not taxable." But, the Commission then pointed to *PLRs 01-027, 01-030, and 04-008* which provided that, in contrast, charges for such services made in connection with the sale of *prewritten* software are subject to Utah sales tax.

(b) Stand Alone Model

As mentioned above, as part of the same analysis addressing the ASP Model, the Commission concluded that the Stand Alone Model transaction is subject to tax as a sale for tangible personal property due to the fact there is an actual transfer of possession of the canned software; pursuant to the statutory definition, the transfer of possession of tangible personal property constitutes a "sale".

Pursuant to the same analysis addressing the Application Service Fee, the Commission concluded that the monthly licensing fee to Stand Alone Model customers is also subject to Utah sales tax, regardless of where the customer is located.

c. Discussion of Application of Law and Ruling 08-002 to Company

i. Taxability of the Transaction

Company agrees with the Commission's statement of the relevant applicable statues and regulations, as summarized above in Section A.1.i.d, and thus the applicable authority will not be restated here. Although Company would assert the Subscription Fee is charged for a service provided, Company recognizes that, in analyzing the Subscription Fee, the Commission may take the position under the primary object test that Company's clients are primarily purchasing a non-transferable right to use software, i.e., the application software, as was concluded in Ruling 08-002. Additionally, Company recognizes that the Commission may take the position that Company's application software constitutes "canned software", despite the client's ability to customize the software to its specific needs. Company acknowledges that canned software constitutes tangible personable property ("TPP") and the "sale" of TPP is a taxable transaction. Company understands that, pursuant to its analysis in Ruling 08-002, the Commission takes the position that a charge for the "use" of canned software will also constitute a taxable "sale" under Utah Code Ann. §59-12-102(83)[8] even where there is no transfer of possession or control of the

7 Note that the Ruling contains a typographical error citing to "Utah Admin. Code R865- 95S-92(C)"
8 As discussed above, this section addresses the definition of the term "sale": (B) "Sale" includes: (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.

software to the customer, or where there is no delivery to or download by the customer of the software.[9]

ii. Determining the Place of "Use" of Company's Application Software

Due to the fact the Commission did not offer an explicit analysis to support portions of its conclusion in Ruling 08-002, ambiguity remains as to what the Commission's exact approach was in determining the place of the "sale" or "use" regarding the Taxpayer's transactions. Nonetheless, some of the Commission's statements in Ruling 08-002 suggest it took the underlying position that regardless of where the customer is located, the place of sale or use for Taxpayer's Base Service under the ASP Model is Utah, based on the location of Taxpayer's servers in Utah.

(a) Holdings under Ruling 08-002 Support the Position That Application Software Is "Used" at the Location of the Servers

It can reasonably be inferred that the Commission took this position in Ruling 08-002 based on the Commission's determinations that (i) the Set Up and Training fees are subject to Utah sales tax "regardless of where the customer is located"; (ii) the hosting of customer databases on Utah servers constitutes a taxable lease of tangible personal property in Utah; and (iii) that the base software for the ASP Model would be a taxable sale "if the customer took possession of the software and utilized it on their server."

First, we look to the Commission's determination that the Set Up and Training Fees are taxable in Utah "regardless of where the customer is located." As discussed above, the Commission held that the one-time Set Up and Training Fees are subject to Utah sales tax, pointing to *Utah Code Ann. §59-12-102(72),* which provides that amounts to be included in the taxable "purchase price" or "sales price" are charges by the seller for any service necessary to complete the sale. The Commission reasoned that because the Set Up and Training Fees are necessary to complete the sale of the Base Service, such fees must be included in the sale/purchase price of the taxable software, i.e., the Base Service. Although the Commission did not explicitly state that the Base Service is taxable in Utah "regardless of where the customer is located", it stands to reason that if all Set Up and Training Fees are taxable in Utah, regardless of a customer's location, that all sales of the Base Service are also taxable in Utah, regardless of a customer's location. Based on this logical extension of the Commission's conclusion, as well as the Commission's general determination that the Base Service is subject to Utah sales tax, it would appear that the Commission took the position that the place of sale/use for the Base Service is determined by the location of Taxpayer's servers in Utah.

Additionally, the Commission appears to indicate that it takes this position based on its discussion that the base software for the ASP Model would be a taxable sale "if the customer took possession of the software and *utilized it on their server."* (Emphasis added.) As Company

9 See Section IV.A.2 below discussing the Commission's former stated position in Private Letter Rulings 01-027 and 01-030 which appears contrary to this position taken in Ruling 08-002.

would agree, the software applications are utilized on the server; this above-quoted statement by the Commission implies that, because the software is utilized on the server, the place of "use" of the software is the location of the server, not necessarily the location of the customer.

Lastly, this position is implied based on the fact that the Commission determined that the hosting of customer databases on Utah servers constitutes a taxable lease of tangible personal property in Utah. Although the Commission addresses the "lease" of the server space as a separately taxable transaction from the "sale" of the base software (i.e., Base Service), the Commission does note that the base software is utilized to establish and maintain the customer databases which are hosted on Taxpayer's servers (i.e., Taxpayer's server space is leased to store the customer databases that are created and maintained via the base software). Thus, the two transactions appear to be inextricably linked and, thus, the place of use of the base software would likewise appear to be tied to the location of the server.

(b) Company's Application Software Cannot be Deemed "Used" in Utah under Use Tax Provisions

In light of the Commission's ambiguity in Ruling 08-002 regarding how the place of sale/use should be determined, we turn to the relevant Utah code and regulations to see if any further guidance is available. As Utah's sales tax provisions do not provide further guidance in determining where the place of "use" is, within the context of Utah Code Ann. §59-12-102(83), we turn to Utah use tax provisions for potential guidance.[10] Utah Code Ann. §59-12-107 addresses obligations of sellers and consumers in the collection and/or remittance of use taxes and Regulation 865-21U-3 which specifically addresses the liability of sellers under code §59-12-107, states the following, in part (emphasis added):

> R865-21U-3.D. When tangible personal property is sold in interstate commerce for use or consumption in this state and the seller is engaged in the business of selling such tangible personal property in this state for use or consumption *and delivery is made in this state,* the sale is subject to use tax. The sale is taxable regardless of the fact that the purchaser's order may specify that the goods are to be manufactured or produced by the seller at a point outside this state and shipped directly to the purchaser from the point of origin. The seller is required to report all such transactions and collect and remit to this state the use tax on all taxable sales. If these conditions are met, it is immaterial that the contract of sale is closed by acceptance outside the state or that the contract is made before the property is brought into the state.
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> R865-21U-3. *Delivery takes place in this state when physical possession of the tangible personal property is actually transferred to the buyer within this state.* Also, when the tangible personal property is placed in the mail at a point outside this state and directed to the buyer in this state or placed on board a carrier at a point outside this state (or otherwise) and directed to the buyer in this state, delivery takes place in Utah.

10 Utah Regulation 865-21U-2A, entitled "Rules Common to Both Sales and Use Taxes Pursuant to Utah Code Ann §59-12-103" states that "The use tax is a compliment to the sales tax and the rules promulgated, when applicable, are common to both taxes.

Pursuant to this regulation, there must be a delivery, i.e., a transfer of physical possession, of the tangible personal property (i.e., the canned software) to a customer in Utah before it can be deemed to be used in the state. Here, because there is never a transfer/delivery of Company's application software, it cannot be deemed to be used by a customer in Utah under Utah's use tax provisions. Moreover, to determine the "use" of the application software takes place where the servers are located, does not conflict with these provisions in any way.

(c) Company's Subscription Fees should Not Be Taxable in Utah Based on the Location of Its STATE 2 and STATE 3 Servers

Based on the above, Company's subscription Fees should be held to be not taxable in Utah because the "use" of the application software takes place in STATE 2 or STATE 3, where Company's servers are located.

As discussed above, there appears to be no guidance in determining where the place of "use" is, within the context of Utah Code Ann. §59-12-102(83), and use of the application software cannot be determined to take place in Utah under Utah's use tax regulations. Furthermore, a determination that Company's Subscription Fee is not subject to Utah sales tax based on the location of its servers outside the state is supported by the holdings of the Commission in ruling 08-002. Lastly, such a determination is the right answer because, simply put, it makes sense. The use of Company's application software takes place where Company's servers are located because the software is hosted on the servers and client's access and utilize the software on the servers; because the software is not downloaded by or transferred to the clients, it is not being utilized on the clients' computers or servers. Therefore, it would be the most logical to determine that the software is being "used" at the location of Company's servers and *not* at clients' locations. Moreover, it would be impractical to determine that the "use" takes place where the client is located due to the fact that, as mentioned above, the Subscription Fee charged to a single client often covers multiple individual users that are located throughout multiple states or countries.

Consequently, Company's Subscription Fees should not be taxable in Utah based on the location of its servers in STATE 2 and STATE 3.

2. Any Determination that the Subscription Fee is Subject to Tax Should Not Apply Before August 4, 2008.

To the extent the Commission determines, contrary to Company's request, that the Subscription Fee is subject to Utah sales/use tax, such determination should be applicable only for transactions occurring on or after August 4, 2008. As discussed above, in Ruling 08-002, the Commission takes the position that a charge for the "use" of canned software will constitute a taxable "sale" under Utah Code Ann. §59-12-102(83) even where there is no transfer of possession or control of the software to the customer, to where there is no delivery to or download by the customer of the software. However, this holding appears directly contrary to the Commission's former public position as stated in Private Letter Rulings 01-027 and 01-030

in which the Commission stated that the use of software is not a taxable transaction where the software is not downloaded by or delivered to the customer.

As quoted directly from Private Letter Ruling 01-030, the Commission stated:

> Utah currently applies its sales and use tax if the customer receives possession of canned computer software, whether the software is received on disk or downloaded by electronic means. On the other hand, if a customer goes to an Internet site to access software without downloading it on his or her own computer, then the customer has not received possession of the tangible personal property; i.e., the canned computer software. [Footnote 1] Nor does Utah currently impose the sales and use tax in this latter circumstance under the theory of renting or leasing tangible personal property because the customer does not have possession of the tangible personal property. Accordingly, for electronic transactions, the software must at least temporarily "reside" in the customer's computer for the transaction to be the taxable sale of tangible personal property. Accessing software at a "host" provider site without downloading the software onto one's computer is not a taxable transaction.
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> Footnote 1: As an example, if a legal database company sends a compilation of all State cases to a customer either in a book, on a disk, or by downloading them electronically, the company has sold tangible personal property. However, Utah does not currently charge sales and use tax on a transaction that allows the customer to use the Internet to view the State cases for a fee on a "host provider," as long as the customer does not download the software onto his or her own computer.

The operative language of Utah Code Ann. §59-12-102(83) upon which the Commission based its conclusion in Ruling 08-002 was in effect at the time Private Letter Rulings 01-027 and 01-030 were issued. Thus, it appears that the Commission has changed its interpretation of this operative language. As such, any determination that the Subscription Fees are taxable in Utah should not pre-date the issuance of Ruling 08-002 due Company's reliance on the Commission's previous rulings pursuant to which the Subscription Fee was not viewed as a taxable transaction.

Very truly yours,

COMPANY
NAME
TITLE

cc: NAME 2 COMPANY

RESPONSE LETTER

April 7, 2009

Ms. Kim Reeder
COMPANY
ADDRESS

RE: Private Letter Ruling Request—Sales Tax Treatment of Services Provided by Your Client ("Company") to Utah Customers.

Dear Ms. Reeder:

You have requested a ruling for your client ("Company") as to the sales tax treatment of Company's sales of Subscription Fees. You have explained the following facts. Company is a STATE corporation based in STATE 2. It engages in business as what is commonly referred to as a "Software-as-a-Service" ("SaaS") provider. A SaaS provider is essentially the same as what is commonly known as an "application service provider" ("ASP"). The Company provides to its clients a comprehensive array of on-demand customer relationship management ("CRM") application services through what is referred to as a "SaaS model." The CRM services utilize application software that resides on the Company's servers, which are located outside of Utah, in STATE 2 and STATE 3. The authorized users remotely access and use the software on these servers via the Internet. Users do not receive the software in any tangible medium nor can they download the software onto their own computers. The Company fully owns and operates the software applications. The Company charges its clients a monthly Subscription Fee for accessing the application software. A client can customize and integrate the CRM application with the client's other software applications using on-demand programming interfaces provided by the Company at no charge. Just as with the CRM application software, the interface software is not downloaded by the client.

In your request, you have referred to Private Letter Rulings ("PLR's") 01-027, 01-030, and 08-002. You provided that the taxpayer in PLR 08-002 had very similar facts to the Company in many aspects, but you also provided one key distinction—in PLR 08-002, the servers were in Utah; for your request, the Company's servers are not in Utah. You have expressed concern that the Commission may apply the reasoning of PLR 08-002 to find that Company's sales of Subscription Fees are subject to Utah sales and use tax even though the Company's servers are located outside of Utah. You have explained that such treatment would be inconsistent with PLR's 01-027 and 01-030, which find no taxable sales in Utah when Utah customers go to an Internet site to access software but they do not download or otherwise receive possession of it in Utah.

You have presented two issues, namely:

"Transactions Occurring On or Before December 31, 2008":

1. Whether the Subscription Fee is subject to Utah sales/use tax pursuant to Private Letter Ruling 08-002, August 4, 2008, and relevant statutes and regulations.

2. To the extent the Commission determines the Subscription Fee is subject to Utah sales/use tax, whether such determination is applicable only for transactions occurring on or after August 4, 2008.

You also stated that you expect to submit a second request on behalf of the Company to address the tax treatment of Company's transactions after January 1, 2009.

We recently addressed issues similar to yours in PLR 08-012, which is not yet published on the Tax Commission's Internet site. Therefore, in this PLR, we are basically restating our position from prior PLR 08-012.

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 92") 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 92, the form in which the software is purchased or transferred is irrelevant.

PLR's 07-013, 01-027, 01-030, 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 01-030, a company sold certain services that included the customers' use via the Internet of software on servers located outside of Utah. The Commission stated:

> Utah currently applies its sales and use tax if the customer receives possession of canned computer software, whether the software is received on disk or downloaded by electronic means. On the other hand, if a customer goes to an Internet site to access the software without downloading it on his or her own computer, then the customer has not received possession of the tangible personal property; i.e., the canned computer software.

In PLR 01-030, the Commission found that the customer's use of the software was not taxable for Utah sales tax when the company retained physical possession of all software and hardware at a facility outside of Utah and the customers did not download the software onto their computers 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

Before beginning, we note that there is no need to distinguish the timing of the transactions. As explained below, the Company's sales of Subscription Fees are not subject to Utah sales/use tax because the Company's servers are located outside of Utah. Therefore, there is no need to discuss whether the transactions occurred before or after August 4, 2008.

In the current situation, the Company is primarily providing access to and use of the prewritten computer software located on the Company's servers. The software involved is not merely incidental to the services of Company. 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

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1 On the other hand, if the primary object of the transaction of Company is to offer services other than providing access to the software and if the software is just a tool of the Company, 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 Company, then the Company would be the consumer of the software not its Utah customers. Additionally, the Company 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.

January 1, 2009, prewritten computer software transferred electronically is excluded from the definition of tangible personal property (*see* § 59-12-102(108)(c) (effective January 1, 2009)) and is 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, Company is selling 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 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." *Id.* Under Rule 92, "[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, Company 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 the Utah customers of Company remotely access and use via the Internet the application software that resides on the Company's servers. The main issue for this PLR is whether the sale of the prewritten computer software occurs in Utah.

PLR's 01-027, 01-030, 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 . . ." PLR 01-030 contains similar language: "if a customer goes to an Internet site to access the software without downloading it on his or her own computer, then the customer has not received possession of the tangible personal property." It is clear from PLR's 01-027 and 01-030 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's 01-027 and 01-030 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, 01-030, and 08-002, Company sells the prewritten computer software, which its clients access remotely. Following the logic of PLR's 01-027 and 01-030, Company's clients might possess the software when the software is downloaded onto the Company servers if the clients are leasing server space. However, because the Company's servers are not located in Utah, the clients do not possess the software in Utah and the sales transactions are not taxable by Utah. The clients' 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's 01-027 and 01-030. PLR 08-002 is clearly distinguishable from the present case because the servers for PLR 08-002 were located in Utah while the servers in this case are 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 servers are located outside of Utah, Company's CRM application 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.

Conclusion

Based on the above analysis, Company's CRM application services that involve granting access to the application software located on the Company's servers 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
09-003