

State Taxation of Cloud Computing

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February 4, 2014

Overview

- Sales tax – taxability
- Sourcing – sales tax and corporate income tax
- Nexus
- Servers and server farms
- Issues for purchasers
- Cloud computing and state tax compliance

SALES TAX – TAXABILITY

Basic Models

- What is cloud computing?
- Cloud computing models
 - Software as a service (SAAS)
 - Platform as a service (PAAS)
 - Infrastructure as a service (IAAS)
- State taxation and the cloud

Sales Tax – Statutory Analysis

- State sales tax statutes impose sales tax on receipts from sales of:
 - Tangible Personal Property (states consider prewritten software TPP); and
 - Enumerated Services.

Is Cloud Computing Prewritten Computer Software?

- Prewritten computer software.
 - Prewritten software is tangible personal property regardless of how delivered; cloud computing software/platforms qualify as prewritten software, therefore cloud computing is taxable licensing of TPP. (E.g., MA Letter Ruling 12-8; NM Ruling 401-13-3; NY TSB-A-08(62)S;; PA SUT-12-001).
- Potential problems with the above approach.
 - No transfer of possession. *See* NJ Technical Bullet No. TAM 4-2103.
 - Does not take into account infrastructure/operations.
 - IAAS likely not software.

Is Cloud Computing an Enumerated Taxable Service?

- Lease (City of Chicago approach).
- Telecommunications service.
- Data processing service (Texas approach).
- Information service (Texas ruling – accessing training course through the internet; Texas Policy Letter Ruling No. 200812241L (December 16, 2008)).
- Digital automated services (Washington approach).

Exemptions

- State Statutory Exemptions May Apply

- Tenn. Code Ann. § 67-6-102(90)(A) excludes from definition of telecommunications service “data processing and information services that allow data to be generated, acquired, stored, processed, or retrieved and delivered by electronic transmission to a purchaser....”
- Virginia Code § 58.1-609.5(1) (“...services not involving an exchange of tangible personal property which provide access to or use of the Internet and any other related electronic communication service, including software, data, content and any other information services delivered electronically via the internet.”).

SOURCING (SALES TAX AND CORPORATE INCOME TAX)

Sourcing Confusion

- Sourcing based on Seller Location (Origin)
 - The cloud product (software) may be stored at multiple locations or server farms located in different states.
- Sourcing based on Customer Location (Destination)
 - Purchaser of the cloud product may be a business with locations/users in multiple states.
 - Purchaser of the cloud product may be an individual that travels to multiple states and that accesses the cloud on a portable laptop , tablet or smartphone.

Sourcing – Sales Tax

- SSUTA.
- Billing address.
- Customer corporate headquarters.
- Assign between states.
- Location of server. (Tenn. Dep't of Rev., Oct. 10, 2011).
- Multiple tax problem?

Sourcing – Corporate Income Tax

- Cost of performance.
- Market-based sourcing.
- Proportionate approach.

NEXUS

Nexus

- Vendors/sellers of cloud computing services.
 - Sales Tax
 - Taxable where they have a physical presence (servers, infrastructure, employees, etc.).
 - Affiliate/attributional nexus?
 - Corporate Income Tax
 - Economic nexus
- Purchasers of cloud computing services.
 - BNA Survey results.
 - Taxable based on leasing space on a server, storing data on a server, using a web hosting service with an in-state server.

Servers and Server Farms

Taxability of hardware stored/leased on a server farm

- Assume that a company provides a service in which it allows customers to store information, data, content, applications and software on its servers (“dumb storage,” arguably IAAS). Is this subject to sales tax?
 - Connecticut – taxable as a data processing service (Conn. Legal Rul. 93-1).
 - Texas – taxable as a data processing service (Texas Policy Letter Ruling No. 201207533L).
 - Kansas – lease of space/hardware/software on Kansas server is subject to Kansas sales tax (Kansas Opinion Letter No. 0-2012-001) (February 6, 2012).

ISSUES FOR PURCHASERS

Issues to consider

- Contracts for cloud computing service.
 - What does the agreement say about sales tax?
 - If sales tax is not collected, and there is an audit, who is responsible for paying the tax?
 - Will the provider be collecting the tax?
- Use tax.
 - Wait until audit?
 - Self-assess?
- Sales tax.
 - Correctly or indirectly being charged on certain products?

CLOUD COMPUTING AND STATE TAX COMPLIANCE

Cloud computing and state tax compliance

- Different state statutory and administrative approaches
- Strategies for companies
 - Letter rulings.
 - Tweak language in contracts.
 - Develop a strong position in high-exposure states with an eye toward defending the position on audit.