COLORADO
Department of Revenue
Taxation Division

Office of Tax Policy
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GIL-14-018

July 28, 2014

XXXXXXXXXXXXXX
Attn: XXXXXXXXXX
XXXXXXXXXXXXXX
XXXXXXXXXXXXXX

Re: Colocation Services

Dear XXXXXXXXXX,

You submitted on behalf of your client ("Company") a request for guidance to determine the applicability of sales and use tax on bandwidth, cross connects and cables used in colocation services, direct private lines, and software programs.

The Colorado Department of Revenue ("Department") issues general information letters and private letter rulings. A general information letter provides a general overview of the relevant tax issues and is not binding on the Department. A private letter ruling provides a specific determination for a specific set of facts, is binding on the Department but not on the taxpayer, and requires payment of a fee. For more information about general information letters and private letter rulings, please see Department Rule 24-35-103.5 at www.colorado.gov/revenue/tax > Tax Library > Rulings.

By letter dated February 27, 2014 we indicated that, because of the complexity of the issues raised by your client, the issues are more appropriately handled as a private letter ruling and that in the absence of such a request, the Department can provide only limited guidance. Company declined to request a private letter ruling. Therefore, the issues in this letter are limited to those areas where the Department can provide general guidance.

Issue

Are bandwidth, cross connects and cables used in colocation services, direct private lines, and software programs subject to Colorado sales or use tax?

Background

Company operates a colocation and hosting facility in the State of Colorado. The colocation is comprised of bandwidth, cross connects, power circuits, and, in some cases, direct private lines between the facility and its customers. The end product that a customer receives is a place to store its servers that is secure from intruders, the elements, and power and Internet connectivity disruptions.

Cross connects are cables connecting one cabinet to another in instances where customer equipment is located in different places within the facility, to provide connection to the Internet, or to connect a direct private line that is located elsewhere in the facility to a customer's cabinet.

Company asks whether the cross connects and cables are the rental of tangible personal property or is a supply used by the client to provide its colocation services. In addition, would the taxability change if the cost was not separately stated on the sales invoice and instead sold in a lump-sum billing.

In addition to bandwidth, Company purchases direct private lines from several different telecommunication providers for use in its colocation and hosting facilities, and the costs are passed through at a marked up rate. The lines consist of various types of copper and fiber connections and may be used to transport either voice or Internet services. The client is not privy to what its customers transmit over the circuits. It is unclear whether the lines are actually resold to the customer or whether they are used or consumed in the process of providing colocation. Company asks if the direct private lines are deemed to be an item purchased for resale to its customers, are they considered to be an exempt Internet service, a taxable rental of tangible personal property, or a taxable telecommunications service. If the direct private lines are taxable, may Company continue to pay sales tax to the vendor and only collect sales tax (or remit consumer's use tax) on the mark-up? Would the outcome change if Company billed its customers on a lump-sum basis rather than providing customers and itemized invoice?

Lastly, Company uses a number of software programs to allow the customer to remotely manage the servers to which they have subscribed, provide data back-up services, and other functions as part of its managed hosting services. Company only provides the customer a non-exclusive, non-transferable, limited use license to the software program and only to the extent it is need for the contract. The costs are not independent of the hosting services and are not recovered from the customer in an itemized charge. Company asks whether this qualifies as a taxable sale. If so, does it make any of the other changes or lump-sum charge for coloration and or managed hosting taxable?

Discussion

Company asks whether charges relating to collocation facilities constitute charges for the rental of tangible personal property or are charges for non-taxable services. These charges relate to cables that connect servers, connect to the Internet, or connect to a private line located in the collocation facility. Whether a transaction involving the use of tangible personal property is a taxable rental of the property or the provision of a nontaxable service will depend on which is the true object of the transaction. This is a particularly difficult determination to make when addressing computer software and related hardware. The Department considers a number of factors. One of the principal factors is the degree of control exercised by the customer.[1] We note that customers apparently exercise some level of control remotely over the servers by use of computer software provided by Company. Other factors to consider may include who owns the software operating on the servers, who bears the risk of loss (insurance), contract terms, and how the parties treat the property for federal tax purposes.

Company purchases private lines from telecommunication service providers and passes the cost of such lines at a marked-up price to its customers. Private lines can be used by customers for two-way communications, but Company does not know whether customers use the lines for such purposes. Charges for private lines used to provide intrastate telephone and telegraph services are subject to sales tax.[2] If customers are using the private lines for such purposes, Company must collect sales tax on the charges paid by customers, including any mark-up.

The taxpayer utilizes computer software that allows customers to remotely manage the servers, provide data back-up services, and other functions. Charges by application service providers for

[1] *Romantix v. City of Commerce City*, 240 P.3rd 565 (Colo. App. 2010).
[2] §39-26-104(1)(c) C.R.S.

use of computer software are not subject to sales tax.[3] We are not given enough information to provide guidance on whether such software is ASP computer software.

Miscellaneous

This letter represents the good faith opinion of Department personnel who are knowledgeable on state taxes issues. However, the Department does not make a specific determination here on any of the issues raised and the Department is not bound by this general information letter.

The Department administers state and state-administered local sales and use taxes. This letter does not address sales and use taxes administered by home-rule cities and home-rule counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our web site at www.colorado.gov/revenue/tax for more information about state and local sales taxes.

Enclosed is a redacted version of this letter. Pursuant to statute and regulation, this redacted letter will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted letter.

Sincerely,

Office of Tax Policy
Colorado Department of Revenue

[3] §39-26-102(15)(c)(I)(C) C.R.S.