COLORADO
Department of Revenue
Taxation Division

Office of Tax Policy
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PLR-11-007

December 20, 2011

XXXXXXXXXXXXX
Attn: XXXXXXXXXX
XXXXXXXXXXXXX
XXXXXXXXXXXXX

Re: Private Letter Ruling

Dear XXXXXXXXXXX,

Deloitte submitted on behalf of XXXXXXXXXX. ("Company") a request for a private letter ruling to the Colorado Department of Revenue ("Department") pursuant to Regulation 24-35-103.5. This letter is the Department's private letter ruling.

Issues

1. Is the fee charged by Company for the Service, as defined below, a hosted software application or a service?
2. To the extent that the Service is a hosted software, will the Service be subject to Colorado sales or use tax?
3. If the Service is subject to Colorado sales tax, how should the transaction be sourced for:
    a. Sales made at the website, where the only information available to the Company is the location information obtained from the purchaser's credit card?
    b. Sales invoiced to Enterprise customers when the Service purchased for use by users located inside as well as outside of Colorado?

Conclusions

1. The fee charged by Company for the Service is a service.
2. The Service is not subject to Colorado sales or use tax.
3. Not applicable.

Background

Company provides a web-based solution (the "Service") for sending, receiving, and tracking large digital files via the Internet. Customers/users purchase a monthly or annual subscription to the Service for which the sale price varies according to features included in the service package. Some features may be purchased on a pay-per-use basis.

Company provides the Service as follows: At the Company's webpage, customer inputs the email address of the designated recipient. Customer then selects the desired files from its computer hard drive and clicks a button on the webpage to initiate the file upload/send process. Customer receives an email from Company when the file is available for download to recipient. Next, recipient's email inbox receives a notification email which appears as from the email address of the Company, with a subject message reflecting that the file has been sent by the email address of the customer. Recipient follows links within the body of the notification email that take recipient to the Company's webpage, where recipient then clicks a button to download the file to its computer.

Uploading and downloading of files occurs at Company's server. Company's servers are located outside Colorado. Uploading/sent files are stored for a certain number of days after which the file automatically expires and is deleted from Company's server. The Service includes encryption and virus scanning to secure transfer of files. The Service is entirely web-based. Accordingly, customer/users do not download the Company's software.

Recipients do not pay for downloading the file. Single-users may use the service at no charge to send files containing a certain amount of data each month, but do not receive file storage. Paid users receive a certain amount of file storage on the Company's servers and can control the expiration date on the uploaded/sent files. Some plans include a service to notify customer when files are sent, or customers can purchase a download notification on a pay-per-use basis. Company bills some enterprise customers for the service; however, most customers purchase subscriptions with a credit card at the Company's e-commerce server.

Discussion

With broad strokes, we can say that Colorado imposes sales and use tax on the sale, use, storage, and consumption of tangible personal property, which includes standardized software, but does not impose sales or use tax on services. This request raises at least two difficult issues: whether the transactions at issue are services or the rental of tangible personal property (software and servers), and whether a user located in Colorado is using software and servers hosted in another state.[1] We find it necessary only to address the first issue.

[1] As Company notes in its ruling request, among the many issues entangled here is the issue of whether a "use" of the software and/or server occurs in Colorado. In the legislative declaration to HB10-1192, the legislature stated that the express inclusion of standardized software into the definition of tangible personal property cannot, in and of itself, be understood to imply that hosted software, application service providers, and cloud computing are also subject to sales and use tax. And, of course, the implication cannot be made that they are not subject to tax for the same reasons. As to the issue of where a "use" occurs, Department Regulation 39-26-102.13(3) requires apportionment of sales and use tax on taxable software among states when the software is used in many states. For example, a company that has employees located in a variety of states and who use software located on a server in Colorado must apportion the sales tax to other states based on the number of employees using that software in those other states.

Whether a transaction is the provision of a service (and, therefore, not taxable) or a mixed transaction of both services and the sale (or use) of taxable tangible personal property is difficult to determine. In *Leanin' Tree v City of Boulder*, 72 P.3rd 361 (Colo. 2003), the Colorado supreme court reviewed a number of tests used in Colorado and other states in such an inquiry. The court ultimately adopted a case-by-case approach which looks to the "totality of the circumstances" and whether the transaction is commonly viewed as a sale of services or sale of goods. ("Varied as these analyses may be, they largely share in common some attempt to identify characteristics of the transaction at issue that make it either more analogous to what is reasonably and commonly understood to be a sale of goods, or more analogous to what is generally understood to be the purchase of a service or intangible right." *Leanin' Tree*, supra.)). Factors which the court considered included whether the "true object, dominant purpose, or essence" of the transaction is, in fact, corporeal tangible property or an intangible right or service. *Id.* at 365. ("Whether couched in terms of the true object, dominant purpose, or essence of the transaction, or of the consequential or incidental nature of the transfer of tangible property, the rationales of most courts attempting to characterize inseparably mixed transactions acknowledge, either explicitly or implicitly, that they are not reducible to a single dispositive factor."); *see also* Steven P. Young & Robert D. Walker, *Current Developments: Colorado,* 14 J. Multistate Tax 28, 4 1-45 (2004); Andrew W. Swain, The Taxability of Computer Software in Colorado, 32 Colo. Law. 91, 96 (Dec. 2003).

The essence of the Service is very similar to the ubiquitous email services of Google, Yahoo, and many other web-based providers. Users of such systems send data, including documents, image files, and wave files, to recipients via the Internet. These providers may encrypt the transmissions to secure the transaction and alert recipients that an email is ready to be viewed. Providers store files uploaded by users. In turn, recipients can download these files sent by users. Although it is true that the users "use" the servers of these providers and the software needed to provide the service, we believe that these providers are most commonly understood to be providers of a service, not lessors of computer servers or software.

Another factor to consider, particularly in the context of whether a transaction is a rental, is the degree of control exercised by the user. *Leanin' Tree*, supra; *Romantix v. City of Commerce City*, 240 P3rd 565 (Colo. App. 2010). If the property at issue is primarily under the custody and control of the provider, then there is a tendency to view the transaction as a service. If the user has significant control over the property, then there is a tendency to view the transaction as one for the rental of tangible personal property. Users of the Company's Service have some degree of control over the servers and software. Users initiate the uploading of a file and designate the recipient. Users can control whether files are stored on the system and the duration of that storage. However, these seem minor in relation to the degree of control exercised by the Company, which has physical custody of the property and staff that program and control the systems. In some respects, this is similar to the case of a person who rents both a truck and a truck operator for a single price: the operator has custody and control over the truck, although the customer has some control where and when it is operated. Colorado, as do many other states, views the transaction as the provision of a service and not the rental of tangible personal property.

As noted above, this is a difficult issue. In the end, we believe that the transaction described in the ruling request is a service, not the rental of tangible personal property, and, therefore, not subject to sale and use taxes administered by the Department.

Miscellaneous

This ruling applies only to sales and use taxes administered by the Department. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes.

This ruling is premised on the assumption that the Company has completely and accurately disclosed all material facts. The department reserves the right, among others, to independently evaluate Company's representations. This ruling is null and void if any such representation is incorrect and has a material bearing on the conclusions reached in this ruling. This ruling is subject to modification or revocation in accordance to Department Regulation 24-35-103.5

Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling 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 version of the ruling.

Sincerely,

Office of Tax Policy
Colorado Department of Revenue