
State of South Carolina
Department of Revenue
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Website Address: <http://www.sctax.org>

SC PRIVATE LETTER RULING #10-2

SUBJECT: Online Subscription Services
(Sales and Use Tax)

REFERENCES: S. C. Code Ann. Section 12-36-910 (2000; Supp. 2009)
S. C. Code Ann. Section 12-36-1310 (2000; Supp. 2009)
S. C. Code Ann. Section 12-36-1110 (Supp. 2009)
S. C. Code Ann. Section 12-36-1910 (Supp. 2009)
S. C. Code Ann. Section 12-36-1920 (Supp. 2009)
S. C. Code Ann. Section 12-36-1930 (Supp. 2009)
SC Regulation 117-329.4 (Supp. 2009)

AUTHORITY: S. C. Code Ann. Section 12-4-320 (2000)
S. C. Code Ann. Section 1-23-10(4) (2008)
SC Revenue Procedure #09-3

SCOPE: A Private Letter Ruling is an advisory opinion issued to a specific taxpayer by the Department to apply principles of law to a specific set of facts or a particular tax situation. It is the Department's opinion limited to the specific facts set forth, and is binding on agency personnel only with respect to the person to whom it was issued and only until superseded or modified by a change in statute, regulation, court decision, or another Departmental advisory opinion, providing the representations made in the request reflect an accurate statement of the material facts and the transaction was carried out as proposed.

Questions:

1. Are the subscription services, ABC Communicate and ABC Connect, offered by 123 Corporation as described in the facts subject to the sales and use tax?
2. If the subscription services, ABC Communicate and ABC Connect, are subject to the sales and use tax, are all the fees associated with the subscription service as described in the facts subject to the sales and use tax?

3. If the subscription services, ABC Communicate and ABC Connect, are subject to the sales and use tax and the customer contracts for a single monthly fee for all services described in the facts, is the entire monthly fee subject to the sales and use tax?

4. If the subscription services, ABC Communicate and ABC Connect, are subject to the sales and use tax, how would the services be sourced for purposes of the sales and use tax?

Conclusions:

1. The subscription services, ABC Communicate and ABC Connect, offered by 123 Corporation as described in the facts are subject to the sales and use tax.

2. Since the subscription services, ABC Communicate and ABC Connect, are subject to the sales and use tax, all the fees associated with the subscription service as described in the facts are a part of the gross proceeds of sales and subject to the sales and use tax.

3. If the subscription services are billed for one itemized price, the entire price is subject to the sales and use tax since the individual charges do not represent “distinct and identifiable properties or services.”

4. The charges imposed by 123 Corporation for its subscription services, ABC Communicate and ABC Connect as described in the Facts, are sourced to the primary business street address of the end user. In other words, these charges should be sourced to the business location where the end user who accesses or uses the subscription service is primarily located.

Facts:

123 Corporation (“123”), headquartered in State X has a division, ABC. ABC is a web-based (hosted) on-demand collaboration platform that provides organizations and business communities with secure access to information and client applications. The platform delivers information and applications to any web browser, provided the end user – no matter where they reside – has the appropriate credentials.

ABC’s business activity is to provide service solutions to businesses in industries that require secure communications of data, primarily automotive, healthcare and government agencies. These services allow ABC’s clients, hereafter known as “Subscriber,” to interact and communicate with their suppliers, employees, vendors, etc., through electronic means. Collectively, they are hereafter referred to as Trading Partners. ABC does not market service solutions directly to consumers.

Depending on the type of service the Subscriber requires, the Subscriber enters into a Product and/or Service Agreement (“Agreement”) with ABC and all fees and services to be provided under the Agreement are set forth in the Customer Service and Fees Schedule (“SAFS”). Additionally, depending on the Agreement, a description of project scope, schedule and responsibilities of the parties and terms specific to the professional services required for the

development, implementation effort and operation will be contained in the Statement of Work (“SOW”).

ABC is not a part or an agent of any Trading Partner in the transactions conducted via the Exchange; nor does ABC maintain a database of information; they merely provide the infrastructure to allow the various users to communicate and transact business with each other in an electronic environment.

ABC offers two distinct subscription service applications (“Offerings”) to its Subscribers; ABC Communicate and ABC Connect, which are described in detail below. The Offerings are offered independently of each other, and although they may work together, it is not necessary that the customer contract for more than one Offering.

All of the Offerings are accessed via the Internet using the customer’s own HTTP(S) software and the Subscriber is responsible for procuring any equipment needed to access the Internet.

ABC services are not classified or reported as software license revenue, but as application services or professional services revenue for tax, revenue, SEC and books and records purposes. ABC is in the business to provide professional services related to the movement of data. The services are not considered to be a product related service, or a service subsequent to the sale of software.

Delivered as a service, no licensee costs exist and fees are based on a subscription service model. Compared to a typical Application Service Provider (“ASP”) arrangement, when the customer terminates their hosting agreement with the ASP provider, the customer retains ownership of the software that they have licensed. However, when a customer terminates their subscription with ABC, the customer takes nothing away for future use as only services are provided to the customer.

In addition to the services, ABC offers, for sale to the customer, one software product, ABC Gateway (“Gateway”). The customer enters into a separate license agreement for Gateway and the sale is considered and booked as license revenue. Gateway is an ancillary item, which may be used with an Offering; however it is separately contracted and invoiced for. It is not bundled with, nor is it mandatory to be purchased as part of the Offerings as the customer can license this type of software from third-party vendors as well. Additionally, the applicable South Carolina sales tax is calculated and listed as a separate line item on such invoices.

The two subscription services, ABC Communicate and ABC Connect, are described below:

ABC Communicate

ABC Communicate consists of two distinct components; ABC Communicate (Portal) and ABC Trusted Identity Framework.

ABC Communicate

ABC Communicate in an on-line portal hosted by ABC, co-branded with the Subscriber in which ABC delivers a secure platform and workspace that can be personalized by communities of users across multiple organizations.

The Services are comprised of the one-time development and on-going hosting of the Subscriber's Portal. The Portal includes a security integration that allows access to authorized Users to Proprietary Resources ("Resources") in accordance with permissions designated by the Subscriber. Resources can include any marketing, information resources, confidential medical records or software applications that are proprietary to the Subscriber. "User" shall mean an individual who is registered with an ID on the ABC Industry Portal.

Implementation Fee: Once a Subscriber contracts with ABC to host a Portal site ("Site"), ABC's personnel design and build a Site with the specific content and layout as required by the Subscriber. This is most easily described as web-site development. ABC hosts the web site and applications of the Subscriber on their servers. The Site contains links to various Subscriber Resources. ABC also secures the Site, and provides security integration to various Subscriber Resources. The Subscriber is charged a one-time up-front fee for the services.

Subscription Fee: Once the Portal is implemented, ABC will provide maintenance to the Site for a specified period of time ("Period") at no additional cost to the Subscriber. After the Period expires, the Subscriber may elect to have ABC continue to maintain the Portal content for an additional fee to cover maintenance and hosting of the Portal Service. Subscription fees include the following services: (a) maintenance of the unique and non-unique Subscriber portal code base, (b) maintenance, testing and validation of the unique and non-unique Subscriber code to support upgrades to the core infrastructure products, (c) testing of all enhancements to ensure continued functionality, (d) 24x7 Help Desk support services, and (e) specified number of users. Help Desk services are performed by a Third Party Vendor and their fees are built into the total Maintenance Fee to the Subscriber. Additionally, ABC will operate and maintain the portal as a hosted service and is only responsible for the services hosted on the server.

For a User to gain access to the Resources, the Subscriber must grant access to the User. Once approved, the User gains access through the Portal via specific links for each Resource and the Supplier is responsible for managing access at a User level.

Application Federation: In order to easily provide a User with access to the Resources, ABC also provides federated login capabilities which allow the Users to access the Subscriber's Resources using their ABC User ID & Password, without needing a separate login ID from the Subscriber. A one-time charge to set up the coding and

security integration is performed as a professional service by ABC's personnel in State X.

ABC Trusted Identity Framework

ABC's Identity Management products, collectively referred to as the ABC Trusted Identity Framework, are designed to allow companies and governments to share information and applications with their extended enterprise, including suppliers, partners, joint ventures, as well as citizens or end consumers. It also offers the tools to manage corporate employee access to resources and applications hosted outside of the company, such as benefits enrollment, pay stubs, corporate travel and 401k.

Identity Management Fee: ABC Trusted Identity Framework is similar to Application Federation, but can be offered outside of the Portal umbrella. Instead of the User logging in on the ABC Portal to gain access to a Subscriber's Resources, the User will log in directly on the Subscriber's Portal page, and will be "linked" through the ABC network, to verify ID's, passwords, access, etc., before being routed back to the Subscriber's Resource. It allows the Subscriber to control the content of their own Portal page; however, it also provides access to ABC's administrative tools, while ABC will maintain all ID management, access, password resets, etc. for the Users. The Subscriber will be charged a monthly fee for each User for this service.

ABC Connect

ABC Connect is a central data-messaging hub that provides a single connection for a Subscriber's systems to exchange business transactions (messages, data, etc...) in various electronic formats with the systems of its Trading Partners. Separately these are referred to as Supplier / Customer, collectively they are considered to be Trading Partners. ABC Connect consists of two distinct components; ABC Connect ("Messaging") and Supplier Connection.

ABC Connect

For any number of reasons, Trading Partner A may wish to send an electronic message ("Message") to Trading Partner B. Via ABC Connect, Trading Partner A's internal software triggers an electronic message to Trading Partner B. Each message is transmitted entirely between the network of each Trading Partner via the Internet through ABC's server in State Y and messages can be tracked via communication code, which provides the address of the computer that transmits the message.

ABC personnel must perform certain professional services before ABC Connect can become operational for the client. Those services, as well as those performed during the transmission of messages allow for the continual transmission of information between the Trading Partners. As such, the Trading Partner may be charged for the following fees:

Set up Fee: Both Supplier and Customer are charged a one-time user set up fee, for professional services performed by ABC personnel. This allows ABC personnel to

obtain the necessary data in order to set up the relationships between the Trading Partners, which in turn will allow them to send and receive messages.

Trading Partner Maintenance Fee: The Suppliers and Customers are charged a monthly fee based upon the number of Trading Partners they have a relationship with. This service allows the Trading Partners to configure, support and maintain locations and establish relationships with other Trading Partners. For a fee, ABC will maintain and support such relationships.

Mapping Fee: If one Trading Partner's application environment is different than another Trading Partner's application environment, the message must be translated into a customer specific format document which will be readable by each other's application environment. The translation of the message occurs on the ABC Platform in State Y and is based on the mapping code developed by ABC personnel. These are professional services to analyze and develop the code, which will translate the messages to be readable between Trading Partners. This one-time fee is charged on a per map basis.

Map Maintenance Fee: Once the initial mapping is complete, there is an ongoing translation fee, which covers professional services needed during the maintenance term to maintain the coding required to stay current with each Trading Partner's system and translation requirements. The fee applies to each message that has the translation applied to it.

Kilo-character Fee: Each Message is measured by kilocharacters, or by each 1,000 characters transmitted. The Trading Partners are charged a monthly fee based on the volume of kilocharacters sent and received during the billing period and whether there was a translation required in addition to the routing and delivery of the message.

Mailbox Fee: A Mailbox Fee is for professional services to set up the Integration channel, which is the mechanism to send and receive messages between Trading Partners.

Mailbox Maintenance Fee: The Trading Partners may also be charged a monthly service or maintenance fee to maintain the connection for the Trading Partners.

Alternatively, although most Trading Partners are charged separate fees for each service described above, a Trading Partner may contractually secure a monthly fixed price for all of the services described above.

Supplier Connection

Supplier Connection is essentially the same service as ABC Connect; however, instead of using internal software to compose and transmit the messages, the Trading Partner utilizes a web browser to exchange data with other Trading Partners. Supplier Connection Customers are charged for the following fees:

Registration Fee: a one-time registration fee

Configuration Fee: fee for professional services to configure Supplier Connection to fit the Customer's needs.

User Fee: specified monthly or annual fee based on the number of Users registered for the service.

Discussion:

Code Section 12-36-910(A) states:

A sales tax, equal to [six]¹ percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property at retail. (Emphasis added.)

Code Section 12-36-1310(A) reads:

A use tax is imposed on the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State, at the rate of [six]² percent of the sales price of the property, regardless of whether the retailer is or is not engaged in business in this State. (Emphasis added.)

Code Section 12-36-60 defines the term "tangible personal property" to mean:

...personal property which may be seen, weighed, measured, felt, touched, or which is in any other manner perceptible to the senses. It also includes services and intangibles, including communications, laundry and related services, furnishing of accommodations and sales of electricity, the sale or use of which is subject to tax under this chapter and does not include stocks, notes, bonds, mortgages, or other evidences of debt. ... (Emphasis added).

Therefore, the term tangible personal property includes the sale or use of intangibles, including communications, that are subject to South Carolina sales or use taxes under Chapter 36 of Title 12.

Communications are subject to sales and use taxes under Chapter 36 of Title 12 pursuant to Code Sections 12-36-910(B)(3) and 12-36-1310(B)(3)³, which impose the tax on the:

¹ Code Section 12-36-1110 increased the sales and use tax rate by 1% beginning June 1, 2007.

² See footnote #1.

³ See SC Revenue Ruling #06-8 for other statutes concerning communications subject to the sales and use tax. These other communications statutes are not relevant to this discussion.

gross proceeds accruing or proceeding from the charges for the ways or means for the transmission of the voice or messages, including the charges for use of equipment furnished by the seller or supplier of the ways or means for the transmission of the voice or messages (Emphasis added.)

The Department has long held that the literal meaning of Code Sections 12-36-910(B)(3) and 12-36-1310(B)(3) imposes the sales and use tax on the total amount of money derived, exclusive of deductions, from a commercial venture and accruing or proceeding from charges for the manner, method or instruments for sending a signal of the voice or of messages is subject to the sales and use tax. See SC Revenue Ruling #89-14, SC Revenue Ruling #04-15 and SC Revenue Ruling #06-8.

Furthermore, the definition of tangible personal property, as defined in Code Section 12-36-60, includes services and intangibles "the sale or use of which is subject to tax under [Chapter 36]," such as "communications." The Second College Edition of the American Heritage Dictionary defines "communication," in part, as "[t]he exchange of thoughts, messages or information, as by speech, signals or writing." "Communications" is defined, in part, as, "a means of communicating esp.: a system of sending and receiving messages, such as mail, telephone and television." The Department has long used the definition found in the Second College Edition of the American Heritage Dictionary for the term "communications."

Based on the above discussion, it is the Department's position that charges for the ways or means of communication include charges for access to, or use of, a communication system (the manner, method or instruments for sending or receiving a signal of the voice or of messages), whether this charge is based on a fee per a specific time period or per transmission. This is further supported by the definition of the terms "sale" and "purchase," which are defined in Code Section 12-36-100 to include "a license to use or consume." See SC Revenue Ruling #89-14, SC Revenue Ruling #04-15 and SC Revenue Ruling #06-8.

The Department of Revenue has taxed communication services such as telephone services, paging services, answering services, cable television services, satellite programming services (includes, but is not limited to, emergency communication services and television, radio, music or other programming services), fax transmission services, voice mail messaging services, e-mail services, and database access transmission services (on-line information services), such as legal research services, credit reporting/research services, and charges to access an individual website.

In addition, SC Regulation 117-329.4 states:

The following are examples of communication services that are subject to the sales and use tax (unless otherwise listed as non-taxable in 117-329.5 or otherwise exempt or excluded under the law):

(a) Telephone services, including telephone services provided via the traditional circuit-committed protocols of the public switched telephone network ("PSTN"), a wireless transmission system, a voice over Internet protocol ("VoIP"), or any of other method

- (b) Teleconferencing Services
- (c) Paging Services
- (d) Answering Services
- (e) Cable Television Services
- (f) Satellite Programming Services and Other Programming Transmission Services, including, but is not limited to, emergency communication services and television, radio, music or other programming services
- (g) Fax Transmission Services
- (h) Voice Mail Messaging Services
- (i) E-Mail Services
- (j) Electronic Filing of Tax Returns when the return is electronically filed by a person who did not prepare the tax return
- (k) Database Access Transmission Services or On-Line Information Services, including, but not limited to, legal research services, credit reporting/research services, and charges to access an individual website (including Application Service Providers)
- (l) Prepaid Wireless Calling Arrangements (sale or recharge at retail) as defined in Code Section 12-36-910(B)(5)
- (m) 900/976 Telephone Service (Emphasis added.)

Based on the above, the retail sales by 123 Corporation of its subscription services, ABC Communicate and ABC Connect as described in the Facts, are subject to the sales and use tax since charges for these services are charges for access to, and use of, a communication system or service.

Code Section 12-36-90 defines the term “gross proceeds,” the basis for sales and use tax on communication services, in part as:

...the value proceeding or accruing from the sale, lease, or rental of tangible personal property... without any deduction for... the cost of materials, labor, or service... [or] any other expenses....

In *Meyers Arnold, Inc. v. South Carolina Tax Commission*, 285 S.C. 303, 328 S.E.2d 920, 923 (1985), the Court of Appeals of South Carolina held the element of service involved in a lay

away sale was subject to tax as being part of the sale of tangible personal property. The test used by the court was as follows:

... But for the lay away sales, Meyers Arnold would not receive the lay away fees. The fees are obviously charged for the service rendered in making lay away sales. For these reasons, this court holds the lay away fees are part of the gross proceeds and subject to the sales tax.

Accordingly, the total amount charged in conjunction with the sale or purchase of tangible personal property, which includes communication services, is subject to the tax.

With respect to the gross proceeds of the ways or means of the transmission of the voice or messages, Code Sections 12-36-910(B)(3) and 12-36-1310(B)(3) state:

(b)(i) for purposes of this item, a "bundled transaction" means a transaction consisting of distinct and identifiable properties or services, which are sold for one nonitemized price but which are treated differently for tax purposes;

(ii) for bills rendered on or after January 1, 2004, that include telecommunications services in a bundled transaction, if the nonitemized price is attributable to properties or services that are taxable and nontaxable, the portion of the price attributable to any nontaxable property or service is subject to tax unless the provider can reasonably identify that portion from its books and records kept in the regular course of business for purposes other than sales taxes.

Based on the above, all charges imposed by 123 Corporation for its subscription services, ABC Communicate and ABC Connect as described in the Facts, are a part of the "gross proceeds of sale" of the communication service and subject to the sales and use tax. If the subscription services are billed for one itemized price, the entire price is subject to the sales and use tax since the individual charges do not represent "distinct and identifiable properties or services."

Finally, Code Section 12-36-1920 states:

For the purposes of telecommunications sourcing:

(1) Except for the defined telecommunication services in item (3), the sale of telecommunication service sold on a call-by-call basis must be sourced to (i) each level of taxing jurisdiction where the call originates and terminates in that jurisdiction or (ii) each level of taxing jurisdiction where the call either originates or terminates and in which the service address is also located.

(2) Except for the defined telecommunication services in item (3), a sale of telecommunications services on a basis other than a call-by-call basis, is sourced to the customer's place of primary use.

(3) The sale of the following telecommunication services must be sourced to each level of taxing jurisdiction:

(a) A sale of mobile telecommunications services, other than air-to-ground radiotelephone service and prepaid calling service, is sourced to the customer's place of primary use as required by the Mobile Telecommunications Sourcing Act.

(b) A sale of post-paid calling service is sourced to the origination point of the telecommunications signal as first identified by either (i) the seller's telecommunications system, or (ii) information received by the seller from its service provider, where the system used to transport the signals is not that of the seller.

(c) A sale of a private communication service is sourced as follows:

(i) Service for a separate charge related to a customer channel termination point is sourced to each level of jurisdiction in which the customer channel termination point is located.

(ii) Service in which all customer termination points are located entirely within one jurisdiction or levels of jurisdiction is sourced in the jurisdiction in which the customer channel termination points are located.

(iii) Service for segments of a channel between two customer channel termination points located in different jurisdictions and the segments of channel are separately charged is sourced fifty percent in each level of jurisdiction in which the customer channel termination points are located.

(iv) Service for segments of a channel located in more than one jurisdiction or levels of jurisdiction and the segments are not separately billed is sourced in each jurisdiction based on the percentage determined by dividing the number of customer channel termination points in the jurisdiction by the total number of customer channel termination points.

Code Section 12-36-1910(9) defines the term "place of primary use" as

the street address representative of the customer's primary use of the telecommunications service, which must be the residential street address or the primary business street address of the customer. In the case of mobile telecommunications services, "place of primary use" must be within the licensed service area of the home service provider.

Code Section 12-36-1910(4) defines the term “customer” as

the person or entity that contracts with the seller of telecommunications services. If the end user of telecommunications services is not the contracting party, the end user of the telecommunications service is the customer of the telecommunication service, but this provision applies only for the purpose of sourcing sales of telecommunications services pursuant to Section 12-36-1920. "Customer" does not include a reseller of telecommunications service or a mobile telecommunications service of a serving carrier under an agreement to serve the customer outside the home service provider's licensed service area. (Emphasis added.)

Code Section 12-36-1910(6) defines the term “end user” as

the person who utilizes the telecommunication service. In the case of an entity, "end user" means the individual who utilizes the telecommunication service. In the case of an entity, "end user" means the individual who utilizes the service on behalf of the entity.

Code Section 12-36-1930 states:

Notwithstanding another provision of law, this article applies to local sales and use taxes on telecommunication services collected and administered by the Department of Revenue on behalf of the local jurisdictions.

Based on the above, for purposes of the sales and use tax, charges imposed by 123 Corporation for its subscription services, ABC Communicate and ABC Connect as described in the Facts, are sourced to the primary business street address of the end user. In other words, these charges should be sourced to the business location where the end user who accesses or uses the subscription service is primarily located.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Ray N. Stevens

Ray N. Stevens, Director

July 29 _____, 2010
Columbia, South Carolina