

SC PRIVATE LETTER RULING 14-2

SUBJECT: X Cloud Service and Y Storage Service
(Sales and Use Tax)

REFERENCES: S.C. Code Ann. Section 12-36-60 (2014)
S.C. Code Ann. Section 12-36-90 (2014)
S.C. Code Ann. Section 12-36-100 (2014)
S.C. Code Ann. Section 12-36-910 (2014)
S.C. Code Ann. Section 12-36-1310 (2014)

AUTHORITY: S. C. Code Ann. Section 1-23-10(4) (2005)
S. C. Code Ann. Section 12-4-320 (2014)
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set forth, and is binding on agency personnel only with respect to the person to whom it was issued and only until superseded or modified by a change in statute, regulation, court decision, or another Departmental advisory opinion, providing the representations made in the request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.

Question:

Are charges by ABC for its X Cloud Service ("X service"), Y Service ("Y service"), and usage fees associated with such services, as described in the facts, subject to South Carolina sales and use tax?

Conclusion:

Charges by ABC for its X service, Y service, and usage fees associated with such services, as described in the facts, are not subject to South Carolina sales and use tax.

Note:

The subject of this advisory opinion is ABC's X and Y services along with certain fees that may be charged in conjunction with such services. This ruling is based on, and only applies to, the X and Y services presently provided by ABC, as described in the facts. In the event that such services change, those changes may provide for a different outcome with respect to sales and use tax consequences in South Carolina.

Facts:

ABC is headquartered in, and has offices in, several states outside South Carolina. ABC owns no data centers but it does utilize large data centers located outside of South Carolina, and in other countries. The data centers are owned and operated by affiliated entities.

ABC's X Service

ABC provides scalable computing capacity for customers. In order to use ABC's X service, customers create a virtual server to run specific services and applications. Customers select a configuration of memory, CPU, and instance storage. ABC provides the X service in units which constitute a specific configuration of computing resources and software. Customers access content through means of an account. Accounts are assigned encryption keys, which customers use to access their content. Customers retain all intellectual property rights to all data and content that they upload.

As part of its X service, ABC makes available to customers a variety of free software, data, and other content as necessary for use of ABC's X service. While customers cannot download any third-party software from ABC to use its X service, they must use some operating system software and/or applications. Thus, customers have three options: (1) use their own software; (2) utilize ABC's open-source operating system software ("open source instance"); or (3) utilize designated third party operating systems software that ABC has licensed ("third party instance").

Open source units consist of software that is free to access by anyone, including ABC, via the Internet. With respect to third party units, ABC will license software from a third party software provider which ABC will use to provide the X service to its customers. ABC is not sublicensing the software to its customers and does not have the right to sublicense the software to its customers. ABC's licensing agreements with third party software providers provide that ABC's customers cannot download the operating system software and that ABC may not transfer the software to its customers. ABC does not charge customers separately for any operating system software that ABC uses to provide its X service with third party instances.

For either open source or third party units, ABC provides its X service using the operating system software running on a virtual server. The software runs only on the virtual server. Customers have no control over the software and the software does not run outside the X environment. Customers cannot download the software; the software runs only on the virtual server. Customers only enter into a service agreement with ABC. Customers do not

enter into an end-user software license agreement with ABC. As a result, ABC does not separately sell or distribute any software with its X service. ABC does not transfer any software to its customers.

Customers may also download free application tools or kits that are used to access and configure its X. These kits include Application Programming Interfaces which are utilized by developers in order to assist with running the customer's applications and programs on ABC's X. Additionally, ABC provides a free web interface used to monitor and manage X. Customers use this to log into their account and perform administrative functions, such as increase or decrease computing power or view their bill and usage history. The free tools may be supplied by ABC, a third party, or developed by customers themselves.

ABC charges customers for its X service based on hourly rates for the computing resources they consume, and ABC generally does not charge based upon any fixed fees. Customers may use the X service at any time, for any length of time. Alternatively, customers may reserve capacity by paying an up-front fee and receive a discount on the hourly rate. ABC does not separately charge its customers for use of any software or applications. ABC charges solely for providing computing resources.

There are also different rates depending upon which operating system is utilized (open source or third party units). Third party units that include third party operating system software that ABC has licensed for its use may be charged at a higher rate. However, open source units that include other operating system software that ABC accesses for free may be charged at a lower hourly rate. Finally, the configuration of an instance (computing resources such as memory, CPU, and instance storage) as selected by the customer generally impacts the hourly rate for the X service.

In addition, ABC also charges its customers usage fee for uploading data, downloading data, or moving data within ABC's network as part of the customer's usage of the X service. A usage fee is only charged in connection with a customer's use of the X service. Lastly, the usage fee is separately stated on the customer's invoice.

ABC's Y Service

ABC's Y service allows customers to store, retrieve, and maintain content, data, applications, and software on servers. Customers can store and retrieve large amounts of data at any time and from any location through the Internet. Customers can do this by setting up an account through the Internet that enables them to upload their content to, and download their content from, servers located outside of South Carolina. A unique electronic key is assigned to each account which allows customers to access stored data. ABC's Y service is also scalable (customers can increase storage space, speed, and robustness to adapt the service to their evolving storage needs).

The Y service is typically used by companies and individual developers. Companies may use it to backup data or store large amounts of data for which they do not have the memory capacity. Web development companies often use it to store temporary data used in setting up a website. Individual developers utilize the Y service to backup and store data.

Customers that utilize ABC's Y service retain ownership of their content. ABC does not have the authority to use, sell, or license customer content on its servers. ABC provides the infrastructure for customers to store digital content. Customers are able to freely access and use their content with only some restrictions on the content that may be stored, including size restrictions.

Customers are not required to download any software or use any applications to use the Y service. Customers upload and download data through various Internet programming languages, which are all freely available (not provided by ABC).

ABC charges customers for the Y service based on the amount of storage capacity they use within a given month and also for the volume of data uploaded or downloaded to/from the server. Charges for the Y service are based on a sliding scale per gigabyte basis with the price decreasing the more a customer stores or transfers data. ABC does not charge customers for use of any software.

Customers may use the Y service without purchasing the X service. ABC also charges its customers a usage Fee for uploading data, downloading data, or moving data within ABC's network as part of the customer's usage of the Y service. The usage fees are only charged in connection with a customer's use of the Y service. Furthermore, the usage fee is separately stated on the customer invoice.

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.

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.

Code Section 12-36-90 defines "gross proceeds of sales" as "the value proceeding or accruing from the sale, lease, or rental of tangible personal property. . . ."

¹ Code Section 12-36-1110 increased the sales and use tax rate from 5% to 6% beginning June 1, 2007.

² See footnote #1.

Code Section 12-36-100 defines “sale” and “purchase” as follows:

“Sale” and “purchase” mean any transfer, exchange, or barter, conditional or otherwise, of tangible personal property for a consideration including:

- (1) a transaction in which possession of tangible personal property is transferred but the seller retains title as security for payment, including installment and credit sales;
- (2) a rental, lease, or other form of agreement;
- (3) a license to use or consume; and
- (4) a transfer of title or possession, or both.

Code Section 12-36-60 defines the term “tangible personal property” as:

...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. ...

Therefore, the term tangible personal property includes the sale or use of intangibles, including communications subject to South Carolina sales or use tax under Chapter 36 of Title 12. Certain communications are subject to sales and use tax under Chapter 36 of Title 12 pursuant to Code Sections 12-36-910(B)(3) and 12-36-1310(B)(3), which impose the tax on the:

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

The Department has long held that Code Sections 12-36-910(B)(3) and 12-36-1310(B)(3) impose 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.³ The Department has taxed communication services such as telephone services, paging services, cable television services, satellite programming services (including, but not limited to, emergency communication services and television, radio, music or other programming services), fax transmission 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.

³ See SC Revenue Rulings #89-14, #04-15, and #06-8.

Conclusion:

ABC's X and Y services, and the usage fees charged for uploading, downloading, or moving data as part of these services, are not subject to the sales and use tax on communication services because they are not charges for the manner, method, or instrument for sending a signal of the voice or of messages. Additionally, these X and Y services are not subject to the sales and use tax because there has been no sale of tangible personal property according to Code Section 12-36-100.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Rick Reames III
Rick Reames III, Director

August 26, _____, 2014
Columbia, South Carolina

CAVEAT: This advisory opinion is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances, as stated, are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting the advisory opinion may not rely on it. If the taxpayer relies on this advisory opinion, and the Department discovers, upon examination, that the facts and circumstances are different in any material respect from the facts and circumstances given in this advisory opinion, then the advisory opinion will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this advisory opinion, changes in a statute, regulation, or case law could void the advisory opinion.