Rhode Island Department of Revenue
Division of Taxation

Declaratory Order 2017-02

Request for Ruling Regarding the Taxability of Cloud Computing Services and Data Transfer Fees

Request for Ruling

Taxpayer requested a declaratory ruling ("Ruling Request") to determine whether sales of certain cloud computing services and fees are subject to Rhode Island sales tax. R.I. Gen. Laws § 42-35-8 and Regulation DR 03-01 govern declaratory order requests.

Facts

The facts set forth below are taken from the statement of facts presented in the Ruling Request dated January 10, 2017.

Taxpayer offers information technology infrastructure services to customers in the form of web services. The services allow customers to access storage capacity and computing power without significant information technology capital investment. Specifically, companies may access server bandwidth and storage capacity through the Internet without having to spend capital on information technology equipment, information technology support staff, or real estate to house the servers.

Taxpayer is headquartered in home state and has offices in multiple states, none of which are currently located in Rhode Island. While Taxpayer does not own any data centers, it does utilize large data centers and smaller clusters of servers ("Point of Presence" locations or "PoP sites") in several locations around the world to provide its services (the "Network"). None of Taxpayer's network sites are currently located in Rhode Island. The data centers and PoP sites are owned and operated by affiliated entities.

I. Storage Service

Taxpayer's remote storage service ("Storage Service") allows customers to store and retrieve content, data, applications, and software on its servers. Taxpayer provides customers with remote access to computing infrastructure so that they can store and retrieve large amounts of data at any time and from any location via the Internet. Customers do this by setting up an account via the Internet that enables them to upload and store their content on Taxpayer's network and later download that content. The remote storage services are also scalable – customers can increase storage space, speed, throughput, and robustness to adapt the service to their evolving storage needs.

Storage Service is typically used by companies and individual developers. Companies may use it to back up data or store large amounts of data for which they do not have the memory capacity, or to store temporary data used in setting up a website. Individual developers generally

utilize the remote storage services to back up and store data in lieu of setting up their own on-premises electronic storage infrastructure.

Customers that utilize Storage Service retain ownership of their content uploaded to Taxpayer's network. Taxpayer does not have the authority to use, sell, or license customer content being stored within Storage Service. Taxpayer provides a service to securely store digital content. Customers do not receive access to or possession of the tangible property, including software and hardware, which Taxpayer uses to store that content in connection with Storage Service.

Customers must select a specific data center or group of data centers to provide Storage Service. However, customers do not have visibility as to the exact server that is hosting their data, nor are they permitted any sort of physical access to Taxpayer's infrastructure. Taxpayer may also move, at its sole discretion, the customer's data from one server to another without notice to the customer to effectively provide the storage service the customer purchases. This is true whether Taxpayer stores customer data on single or multi-tenancy computer equipment (i.e., equipment that provides computing infrastructure to multiple customers at the same time).

Taxpayer makes available, free of charge, certain software development kits and a management console to aid customers in uploading and managing the data they are storing. The management console is a simple and intuitive web interface that allows users to create Storage Service "buckets", which are essentially file folders, and then upload or delete objects in those buckets. These free tools allow customers to manage and make efficient use of the storage service. The free tools are optional; customers may choose to make use of Storage Service without utilizing these free tools.

Customers are charged both a base fee, determined by the amount of gigabytes used in a given month, as well as an incidental usage fee based on their activity while using the service. The flat fee prices are on a sliding scale, per gigabyte, basis. The usage fee is called a "Data Transfer" fee and is described more fully below. Customers are not charged an amount for Internet access or any other similar means of using the Internet to store or retrieve information through Storage Service. Customers are independently responsible for their own Internet connections and telecommunications services.

II. Computing Service

Taxpayer also provides a scalable, virtual computing environment with its Computing Service. Through Computing Service, customers can procure computing resources to perform a variety of activities, including, but not limited to, running applications, monitoring computers and computer usage, and hosting web domains – essentially anything computer equipment, especially a computer server, can do. The service's core benefit is that it allows customers to obtain remote access to computing capacity and control of their computing resources without a significant information technology investment (i.e., customers no longer have to buy their own servers or set up and maintain their own on-premises data centers). In the technology industry, Computing Service is commonly referred to Infrastructure as a Service ("IaaS").

To use Computing Service, customers request a configuration of memory, CPU, storage, and operating system. This configuration is called an "Instance" and is the basis for the fee the customer is charged for Computing Service usage.

Customers are not required to use specific software to use the service. Nor do they download any software as part of an Instance. However, some basic operating system is required to direct the computing power. Therefore, access to an operating system is provided with each Instance. Customers can use the operating system to upload the applications that they wish to run using Taxpayer's computing power and can use application programming interfaces to allow their existing systems to communicate with Computing Service. Specifically, Taxpayer makes available either open source or third party operating system software with each Instance so that customers can make use of the virtual servers. The open source operating system software used in an "Open Source Instance" is freely accessible by anyone over the Internet. Customers may also opt to use a third party operating system in a "Third Party Instance".

Whether a customer selects the Open Source or Third Party Instance option, the operating system software runs on servers within Taxpayer's network to provide Computing Service. Customers do not receive a license to use the operating system, or any other, software; do not receive a physical copy of any software; and cannot electronically download the operating system software for their own use. Customers also cannot access the physical remote location where the servers which host the software are located.

A customer's use of this operating system software is only in conjunction with the use of Computing Service. Taxpayer does not separately license, sell, or transfer any software with its Computing Service. As such, Taxpayer's Computing Service is not classified as a Software as a Service ("SaaS") offering by the technology industry. Taxpayer's software licensing agreements with third party software vendors explicitly state that Taxpayer's customers cannot download the operating system software. Taxpayer may not in any way transfer the software to its customers.

Customers are also provided free help in the form of application programming interfaces and software development kits that allow them to more easily utilize the computing power. These free tools are optional and are simply posted on web pages. Customers may choose to make use of Computing Service without using these free tools.

Customers retain all intellectual property rights to all of their data and content sent to Taxpayer's network. Customers must represent that they own or license the intellectual property and software that they are uploading to Taxpayer's network. Similar to Storage Service, customers must select a specific data center or group of data centers to provide their computing services but do not have visibility as to which exact server is hosting their data. Taxpayer may move, at its discretion, the customer's data from one server to another without notice to the customer to effectively provide the purchased remote computer power. This is true whether the customer requests computing power from single-tenancy equipment or whether Taxpayer provides computing power from its multi-tenancy computer equipment. The provision of an Instance does not necessarily equate to the provision of a full server or other computer equipment. An Instance may require only some of the capacity of a server which is why

Taxpayer employs multi-tenancy equipment that can provision multiple Instances to multiple customers at the same time.

Computing Service charges are based on the computing resources that the customer requests. Customers are charged both a base fee, determined by the amount of computing power used in a given month, as well as an incidental usage fee based on their activity while using the service. The incidental usage fee is called a "Data Transfer" fee and is described more fully below. Although the Third Party Instances cost customers more than Open Source Instances, licensing expenses are not the only cost driver. Third Party Instances require additional support that is materially different from the support provided for Open Source Instances (e.g., development work required to configure third party software to work properly in a Computing Service environment).

III. Data Transfer Fees

As noted above, customers' usage of Storage Service and Computing Service are subject to a base price measured by gigabytes or computing power, respectively, and may also generate incidental usage charges called "Data Transfer" fees that are separately stated on their monthly bills. These usage fees are based on a customer's activity on Taxpayer's network, such as when a customer wishes to process data in multiple data centers, requests access to resources (i.e., computer equipment) in a new data center, requests that data be copied or moved within Taxpayer's network, or downloads her stored data. In other words, customer decisions about where to store, move, or access their own data within Taxpayer's network may generate Data Transfer fees.

Within Taxpayer's network are clusters of data centers in a similar geographic area that are collectively described as a "Region". For example, the data centers that Taxpayer uses in Oregon are described collectively as the "US West (Oregon)" Region. Taxpayer data centers used in California are collectively known as "US West (Northern California)" Region. Within a Region there are "Availability Zones" that refer to the different data centers that collectively make up the Region. There are multiple Availability Zones within any given Region.

Requests by customers to copy data from one Region or Availability Zone to another (e.g., when storing data with Storage Service) or to coordinate computing power between Regions or Availability Zones (e.g., when using Computing Service) may trigger the incidental usage fees. For example, a customer running her website using Computing Service may wish to run her website applications using Open Source or Third Party Instances in two separate regions simultaneously, necessitating that servers in those two Regions work in concert with each other. This will cause the customer to incur a separately stated usage fee ("Data Transfer") attendant to her Computing Service charge. These are customer decisions about how best to position their own data on Taxpayer's network.

Data Transfer fees act as a metering mechanism that tracks a customer's usage of Taxpayer's services and network and are not fees for underlying telecommunications infrastructure. Both Taxpayer and its customers must obtain and pay their own telecommunications access and usage fees to their respective telecommunications service

providers outside of and independent from Taxpayer's service transaction. Taxpayer's imposition of "Data Transfer" fees is in line with Taxpayer's pay-as-you-go pricing philosophy that charges users more as they use more resources. For example, customers who want stored data to be "backed up" redundantly in multiple Regions will be charged more than customers who simply requested storage in one Region.

Customers can never purchase "Data Transfer" in isolation as there is no "Data Transfer" service. The incidental usage fee is always a consequence of a customer's active use of a different and primary service such as the Computing Service. The following are examples of specific situations in which the customer may incur a Data Transfer fee:

- Adding files – There is currently no fee to add files to Taxpayer's network.
- Moving files among Regions – Fees may be charged when a customer requests coordination of processes running in different Regions. For example, if a customer asks that data stored in one Region be used in a Computing Service-run process in another Region, a fee may apply. Similarly, fees may be charged when a customer requests his or her data be copied to Storage Service (or "backed up") in a different Region.
- Moving files among Availability Zones – If a customer requests that data be moved from one data center to another data center in the same Region (i.e., between Availability Zones in that Region), then a fee may apply.
- Retrieving data – When a customer requests that her data be copied or transferred from Taxpayer's service back to her own origin servers, a fee will apply.

Ruling Requested

Based on the facts provided, Taxpayer's Storage Service, Computing Service with an Open Source Instance, Computing Service with a Third Party Instance, and Data Transfer fee are not subject to Rhode Island sales tax.

Pertinent Local Statutory and Regulatory Law

I. Tangible Personal Property and Services

R.I. Gen. Laws § 44-18-18 imposes a sales tax on all "sales at retail" in Rhode Island. If the sales tax does not apply, the state imposes a use tax under R.I. Gen. Laws § 44-18-20 "on the storage, use, or other consumption in this state of tangible personal property; prewritten computer software delivered electronically or by load and leave; or services as defined in § 44-18-7.3." R.I. Gen. Laws § 44-18-8 defines "retail sales" or "sale at retail" as "any sale, lease or rentals of tangible personal property, prewritten computer software delivered electronically or by load and leave, or services as defined in R.I. Gen. Laws § 44-18-7.3 for any purpose other than resale, sublease or subrent in the regular course of business."

Under R.I. Gen. Laws § 44-18-7(1), the term "sales" means and includes "any transfer of title or possession, exchange, barter, lease, or rental, conditional or otherwise, in any manner or by any means of tangible personal property for a consideration. 'Transfer of possession', 'lease', or 'rental' includes transactions found by the tax administrator to be in lieu of a transfer of title,

exchange, or barter." R.I. Gen. Laws § 44-18-16 defines "tangible personal property" as "personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses. 'Tangible personal property' includes electricity, water, gas, steam, and prewritten computer software."

Per R.I. Gen. Laws § 44-18-7(14), the term "sales" also includes "the sale, storage, use or other consumption of prewritten computer software delivered electronically or by load and leave as defined in paragraph 44-18-7.1(v)." "Prewritten computer software" refers to "'computer software,' including prewritten upgrades, which is not designed and developed by the author or other creator to the specifications of a specific purchaser."[1] "'Computer software' means a set of coded instructions designed to cause a 'computer' or automatic data processing equipment to perform a task."[2] These same definitions of "prewritten computer software" and "computer software" are in Rule 5 of Regulation SU 11-25 and the Streamlined Sales and Use Tax Agreement ("SSUTA"), which Rhode Island must comply with pursuant to R.I. Gen. Laws § 44-18.1-1 *et seq.* and Regulation SST 13-01.[3] Rule 7(3) of Regulation SU 11-25 exempts transactions for software that is hosted on the vendor's equipment for customer access under an existing agreement where no prewritten computer software is downloaded.

Unlike tangible personal property, services are generally nontaxable unless they are specifically enumerated by statute. R.I. Gen. Laws § 44-18-7(16) defines "sales" as "the furnishing of services in this state as defined in § 44-18-7.3." R.I. Gen. Laws § 44-18-7.3 provides a list of taxable services that include taxicab and limousine services, other road transportation services (e.g., charter bus service), pet care services (except veterinary and testing laboratories services), and room reseller services. Regulation SU 87-77 exempts occupational and professional services from sales and use tax.

R.I. Gen. Laws § 44-18-7(9)(i) further defines sales as "the furnishing for consideration of intrastate, interstate and international telecommunications service sourced in this state in accordance with subsections 44-18.1(15) and (16) and all ancillary services, any maintenance services of telecommunication equipment other than as provided for in subdivision 44-18-12(b)(ii)." "'Telecommunications service' means the electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points. The term 'telecommunications service' includes such transmission, conveyance, or routing in which computer processing applications are used to act on the form, code or protocol of the content for purposes of transmission, conveyance or routing without regard to whether such service is referred to as voice over Internet protocol services or is classified by the Federal Communications Commission as enhanced or value added."[4] However,

---

[1] R.I. Gen. Laws § 44-18-7.1(g)(vi).

[2] R.I. Gen. Laws § 44-18-7.1(g)(ii).

[3] Streamlined Sales and Use Tax Agreement, STREAMLINED SALES TAX GOVERNING BD., INC. (Dec. 16, 2016), http://www.streamlinedsalestax.org/uploads/downloads/Archive/SSUTA/SSUTA%20As%20Amended%2012-16-16.pdf, at 59, 106.

[4] R.I. Gen. Laws § 44-18-7.1(y)(i)(G).

"telecommunications service" does not include "Data processing and information services that allow data to be generated, acquired, stored, processed, or retrieved and delivered by an electronic transmission to a purchaser where such purchaser's primary purpose for the underlying transaction is the processed data or information."[5] Rule 6 of Regulation SU 09-129 states that telecommunication services are taxable when sold on a call-by-call basis or some other basis.

Under R.I. Gen. Laws § 44-18-25, all gross receipts are presumed to be taxable until the taxpayer proves otherwise to the Tax Administrator. The burden of proving to the contrary is on the person who makes the sale and the purchaser, unless the person who makes the sale takes from the purchaser a certificate indicating that the purchase was for resale. The certificate must be in the form that the Tax Administrator requires. R.I. Gen. Laws § 44-18-30 provides a list of specific exemptions to the sales and use tax in Rhode Island. If a good falls outside of this list, it is generally taxable.

II. Bundled Transactions

R.I. Gen. Laws § 44-18-7.1(c) defines a bundled transaction as "the retail sale of two or more products, except real property and services to real property, where (1) the products are otherwise distinct and identifiable, and (2) the products are sold for one non-itemized price. A 'bundled transaction' does not include the sale of any products in which the 'sales price' varies, or is negotiable, based on the selection by the purchaser of the products included in the transaction." If even one of the products in the bundle is taxable, the entire bundled transaction is taxable unless the real object of the transaction is nontaxable.

Rhode Island determines whether bundled transactions are taxable based on the real object test. *New England Telephone and Telegraph Co. v. Clark* spells out three (3) categories into which property and services are typically organized.[6] If the real object of the transaction is tangible personal property, the transaction is taxable. If the real object instead is a nontaxable service, the transaction is not taxable. When the property and service aspects of the transaction are readily separable, but each is consequential, then the property and service elements must be analyzed as separate transactions for tax purposes. Rhode Island's past cases on the real object test have primarily dealt with the taxability of real estate listing booklets (taxable)[7], mechanical layouts and color overlays for toy packaging (taxable tangible personal property exempted as a manufacturing component)[8], telecommunications equipment and engineering services to update a

---

[5] R.I. Gen. Laws § 44-18-7.1(y)(i)(G)(1).

[6] 624 A.2d 298, 300-01 (R.I. 1993)

[7] *Statewide Multiple Listing Serv. v. Norberg*, 392 A.2d 371, 372 (R.I. 1978).

[8] *Hasbro Indus. v. Norberg*, 487 A.2d 124,125, 127 (R.I. 1985).

switching office (personal property and services were readily separable)[9], and videotaped depositions (case remanded on an evidentiary issue)[10].

Discussion

I. Storage Service

When a customer buys Taxpayer's Storage Service, he or she pays for digital storage space for data, applications, and software. The customer does not buy any tangible personal property, prewritten computer software, or specifically enumerated taxable services under R.I. Gen. Laws § 44-18-7.3. Storage Service may look similar to a telecommunications service under R.I. Gen. Laws § 44-18-7.1(y)(i)(G) because it involves "the electronic transmission, conveyance, or routing of... data... or any other information or signals to a point, or between or among points." However, in general, telecommunications services refer to the transmission of telephonic messages, not the storage of data.[11] Storage Service customers do not use Storage Service primarily to route voice and other data between locations.

Storage Service is instead more akin to "data processing and information services that allow data to be generated, acquired, stored, processed, or retrieved and delivered by an electronic transmission to a purchaser where such purchaser's primary purpose for the underlying transaction is the processed data or information."[12] Such services are not telecommunications services under R.I. Gen. Laws § 44-18-7.1(y)(i)(G)(1). Customers who purchase Storage Service primarily do so to store data, not to route communications to other individuals.

Customers may buy more or less digital storage space on Storage Service as needed for a base fee. Customers may even use free optional software development kits and/or a management console to help upload and manage the data they want to store. However, none of these items falls into a taxable category. Therefore, Storage Service is not subject to Rhode Island sales tax.

II. Computing Service with an Open Source Instance

Computing Service does not involve the sale of tangible personal property. In the technology industry, Computing Service is called IaaS – remote access to computing capacity and control of computing resources. In lieu of purchasing hard drives, servers, and other computing equipment, Computing Service customers only purchase a configurable Instance (combination of memory, CPU, storage, and operating system) in the cloud with access to a basic operating system. Taxpayer's customers then use these Instances to perform the work they want to accomplish. Customers receive no physical copies of any software.

---

[9] 624 A.2d at 301-02.

[10] *White v. Clark*, 823 A.2d 1125, 1126, 1128 (R.I. 2003).

[11] *See* R.I. Gen. Laws § 44-18-7.1(y)(i)(G); Regulation SU 09-29, Rule 6.

[12] R.I. Gen. Laws § 44-18-7.1(y)(i)(G)(1).

Nor does Computing Service involve the sale of prewritten computer software, even though an operating system qualifies as prewritten computer software under R.I. Gen. Laws § 44-18-7.1(g). An operating system qualifies as "prewritten computer software" because it contains a set of coded instructions that cause a computer to perform a task and is not developed to the specifications of a specific purchaser. Taxpayer does not separately license, sell, or transfer any software with its Computing Service. Nor do Taxpayer's customers download any software as part of an Instance. Taxpayer's software licensing agreements with third party software vendors explicitly prohibit Taxpayer's customers from downloading or receiving operating system software. This software runs on servers within Taxpayer's network to provide Computing Service. Customers have no physical access to or control over Taxpayer's server that runs the operating system hardware. They can only use the operating system software in conjunction with Computing Service.

Computing Service is not an explicitly enumerated service under R.I. Gen. Laws § 44-18-7.3. Even if Computing Service involved the sale of a vendor's platform to host software (SaaS), such a service is not taxable as long as prewritten computer software is not downloaded. Computing Service is also not a taxable telecommunications service because its primary purpose is processed data or information per R.I. Gen. Laws § 44-18-7.1(y)(i)(G)(1). Taxpayer's customers do not purchase Computing Service to route voice or other data between locations. The primary purpose of Computing Service is remote access to computing power for running applications, monitoring computers, hosting web domains, and other functions that computers can perform. Although it may be possible for Computing Service to perform telecommunications services, telecommunications are not the primary purpose of the service.

Nor is Computing Service a bundled transaction. Taxpayer's customers pay for access to computing power, not two or more distinct, identifiable products for a non-itemized price. An operating system does not count as an item that is purchased with the computer power. Customers do not purchase or download the operating systems on Taxpayer's servers. Customers pay a base fee that is determined by the amount of computing power they use each month. In other words, customers pay only for the computing power that they use, which means the sales price varies based on the customer's selection of products to include in the transaction. This is also true with the incidental usage fees (Data Transfer fees) that customers may pay for transferring data within Regions or copying data from Taxpayer's servers to their own servers. Even if Computing Service were considered a bundled transaction, the real object test suggests that the primary purpose of a Computing Service transaction is access to computing power, not the sale of prewritten computer software. For these reasons, Computing Service with an Open Source Instance is not subject to Rhode Island sales tax.

III. Computing Service with a Third Party Instance

For the same reasons that Computing Service with an Open Source Instance is nontaxable, so is Computing Service with a Third Party Instance. It makes no difference for tax purposes that a Third Party Instance costs customers more than an Open Source Instance because of Taxpayer's licensing expenses and the additional support that Third Party Instances require. The operating systems that customers use for Computing Service are licensed by Taxpayer, not

its customers. Customers do not receive a license to use the operating system, or any other, software; they do not receive a physical copy of any software; and they cannot electronically download the operating system software for their own use. Taxpayer does not separately license, sell, or transfer any software with Computing Service. Therefore, Computing Service with a Third Party Instance is not subject to Rhode Island sales tax.

IV. Data Transfer Fees

Unlike Storage Service and Computing Service, Data Transfer fees are not a particular Taxable service. These fees are a means of tracking a customer's usage of Taxpayer's cloud services. Data Transfer fees are separately listed on each customer's bill, but they are directly related to his or her Storage Service and Computing Service usage. For Storage Service, Data Transfer fees apply when customers request access to computer equipment to store data and then later access or retrieve that same data. For Computing Service, Data Transfer fees apply when customers request access to computer power in different data centers (Regions or Availability Zones). As is true for the underlying Storage Service and Computing Service base fees, Data Transfer fees are also not fees for telecommunication services. For these reasons, Data Transfer fees are not subject to Rhode Island sales tax.

Ruling

Based on the facts provided, Taxpayer's Storage Service, Computing Service with an Open Source Instance, Computing Service with a Third Party Instance, and Data Transfer fees are not subject to Rhode Island sales tax.

This ruling is limited to the facts stated herein and may be relied upon by the Taxpayer and shall be valid unless expressly revoked because (1) the applicable statutory provisions of law are amended in a manner that requires a different result; (2) the underlying facts described herein materially change; or (3) a decision on point has been issued by the Rhode Island or Federal courts.

Neena S. Savage
Tax Administrator
March 31, 2017