



North Carolina Department of Revenue

Roy Cooper
Governor

Ronald G. Penny
Secretary

March 5, 2020

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

Re: [REDACTED]
Private Letter Ruling Request
Account ID: [REDACTED]
Taxpayer's FEIN: [REDACTED]

Dear [REDACTED]:

The Department has completed its review of your request for a written determination on behalf of your client, [REDACTED] ("Taxpayer"). In making this written determination, the Department has considered the facts presented in your initial request as well as any supplemental information provided.

This private letter ruling is a written determination issued under N.C. Gen. Stat. § 105-264.2 and applies the tax law to a specific set of existing facts furnished by you on behalf of Taxpayer. This written determination is applicable only to the taxpayer addressed herein and as such has no precedential value except to the taxpayer to whom the written determination is issued.

Overview and Relevant Facts

"[Taxpayer] offers a cloud-based service offering ("Offering") . . . [that] provides "certain cloud-based applications and related services ("Services") that support a customer's telecommunication equipment, including its voice, video, messaging, presence, audio, web conferencing, and mobile capabilities. . . . [The Offering] replaces certain customer-owned and maintained software applications and related computer hardware that support a customer's telecommunications equipment with a [Taxpayer]-hosted alternative. In this hosted alternative, [Taxpayer] owns (or is the lessee or licensee of) and maintains certain hardware and software. The benefit of the [Offering] is that customers can utilize the hardware and software Cloud applications on an as-needed basis. . . . [I]n exchange for a monthly fee, [Taxpayer] will operate back-office equipment and software applications that provide necessary or enhanced functionality for a customer's phone systems and other telecommunication equipment."

Taxpayer "acquire[s], operate[s] and maintain[s] all the hardware and software necessary to provide the [Services] and ensure optimal performance. The hardware and software required for providing the Services will be installed on servers located" outside North Carolina. Taxpayer has

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employees located outside North Carolina that “will provide onsite professional services to maintain the hardware and software, and . . . will remotely monitor performance, perform necessary adds, moves, changes, and deletions, and provide troubleshooting for issues that arise during performance.”

“The [Services] will be provided by [Taxpayer] on a remote basis through the use of [Taxpayer]-owned ██████████ located at a [Taxpayer] data center. The ██████████ will deploy a variety of available [Taxpayer]-owned, client software applications that are utilized by customer-owned phones and workstations located at customer sites.”

The Services utilizes ██████████ an IP telephony software application that operates on an IP infrastructure that provides signaling and call control services to ██████████ integrated telephony applications as well as to third-party applications. In order to perform signaling and call control tasks such as digit analysis, routing, and circuit selection within a Public Switched Telephone Network (“PSTN”) gateway infrastructure, ██████████ uses industry standard IP protocols.

Customers are “responsible for providing connectivity of sufficient bandwidth between the customer’s location and [Taxpayer’s] data center. [Taxpayer] relies on the customer’s QoS-enabled, voice-grade Local Area Network and Wide Area Network over which it provides the [Services] throughout a customer’s geographic locations. . . . All connections between the customer and [Taxpayer’s] datacenter are through a customer’s existing or newly-ordered PSTN circuits, phone lines and Internet connections. The PSTN or other connections can reside throughout the customer locations, and are terminated into the [Taxpayer] data center through customer-owned, [Taxpayer]-managed gateways. Customers are always the ‘customer of record’ for any PSTN, Internet or other service for the transportation or transmission of messages or information; the applications do not transport or transmit messages or information. All customer communications with third parties are through customer-contracted PSTN connections that are not provided by [Taxpayer]. [Taxpayer’s] customers continue to communicate with third parties over the PSTN, and continue to pay their telecommunications provider the same charges and taxes for such capabilities, both before and after signing up for the [Offering]. PSTN communications with third parties are never physically routed through [Taxpayer’s] data center equipment.”

“[Taxpayer] may also host and deploy certain customer-owned software applications that provide enhanced functionalities for a customer’s phone systems and other telecommunication equipment. Such hosted services are available as add-on services for additional fees . . . and are utilized by customers in the same manner as the [Taxpayer]-owned and hosted software applications.”

“To purchase the [Offering], customers will enter into a contract with [Taxpayer] that includes a customer service order [(“CSO”)], a service description for the Offering, and a detailed pricing invoice. . . . [Taxpayer] will charge the customer a monthly ██████████ ██████████ . . . based on the number of users. The monthly fee covers the charges for hardware, software, virtual server instance charges, required storage charges, rack space charges, power and cooling charges, as well as monitoring and management charges, most moves-adds-changes and major version

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upgrades. To the extent the customer purchases add-on services (including the hosting of customer-owned software applications), separate fees are charged for each such service. Charges for maintenance and management of any customer-owned software applications are also separately stated on the monthly invoice.”

In each of the support services described below, “a customer utilizes the [Taxpayer]-owned and hosted software with its own equipment and through its own telecommunication, Internet or other network connection. At no time does the customer download or otherwise possess the software that is hosted by [Taxpayer].” “[Taxpayer] does not provide the telecommunication, Internet or network connections necessary for the customer to utilize the Services.”

Voice. A [Taxpayer] server, utilizing the ██████████ communicates with the customer’s voice gateway device (i.e., the customer-owned switch) to provide instructions to the customer’s voice gateway device for the processing and routing of incoming and outgoing calls among the customer’s phone extensions; the call is not routed through [Taxpayer’s] server. No end-to-end communication is ever routed through [Taxpayer’s] server. This ██████████ system also supports a customer’s other forms of communication to its IP endpoints, media-processing devices, VoIP gateways, mobile devices, and multimedia applications. . . .

Video. Video is the technology of electronically capturing, recording, processing, storing, transmitting, and reconstructing a sequence of still images representing scenes in motion. Video utilizes components such as the ██████████, ██████████ such as the ██████████ or larger units. The video support services will be provided by [Taxpayer’s] server through a ██████████ in the same manner as outlined above with respect to a customer’s voice communication capabilities.

Messaging. When a customer phone extension does not answer an incoming call, the [Taxpayer] server, utilizing the ██████████ instructs the customer’s voice gateway device to send the call to voicemail. The voice messages are then stored on the [Taxpayer’s] servers and available for the user to access and manage at his or her convenience. The voice message support services provided by the [Offering] will allow users to access and manage voice messages stored on [Taxpayer]-owned servers in a variety of ways, using an email inbox, web browser, ██████████ Phone, Smartphones, and ██████████, among other components.

Presence. Presence support services are provided by [Taxpayer] through a ██████████ ██████████ application that provides users the ability to determine when colleagues are available. The ██████████ application offers the flexibility of rich, open interfaces that allow enablement of instant messaging and rich, network-based presence for a wide variety of business applications. . . . [T]he customer’s own communications equipment accesses the ██████████ application hosted on [Taxpayer’s] servers to utilize the ██████████ capabilities.

Audio Conferencing. With respect to a customer’s audio conferencing capabilities, [Taxpayer] supports a customer-owned ██████████ and the phone devices through its hosted ██████████ in a manner similar to that which is described above with respect to the voice support services.

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Web Conferencing. [REDACTED] application is an optional, subscription-based component of the Offering. [REDACTED] is a cloud-based web conferencing application that permits desktop sharing through a web browser with phone conferencing and video. [REDACTED] operates through a user's computer or wireless device, an audio connection (either through the computer or through a phone), and a webcam (optional).

Mobility Services. [Taxpayer] supports a customer's mobile devices through use of the [REDACTED] application. Mobile clients utilizing [REDACTED] can place and receive calls over their own corporate wireless local area network and telephone infrastructure, using [Taxpayer's] server to instruct the routing of calls, and essentially turns a mobile phone into another extension on the [REDACTED]. [Taxpayer's] server itself does not provide the routing for the call or otherwise function as a switch. No end-to-end communication is ever routed through [Taxpayer's] server.

The CSO states there are three services provided by Taxpayer and [REDACTED] collectively referred to as "Purchased Services." The Purchased Services are composed of [REDACTED]. As it pertains to the Purchased Services the [REDACTED] "... will be responsible for the acquisition, configuration, support and performance of the [REDACTED] hardware, software, electrical systems, equipment racks, environmental systems, SONET ring and Internet connections ([REDACTED] Infrastructure')." A customer is limited to use of the "Purchased Services solely for internal business purposes and cannot sell, resell, rent or lease any of the Purchased Services." Customers cannot "modify, copy, or create derivative works based on the Purchased Services. . . [Seller] reserves all rights, title and interest in and to the Purchased Services."

The product of [REDACTED] the Offering and optional services are identified and described in the Service Description for the Offering which accompanies a CSO. The Offering relies primarily on the [REDACTED] System. The infrastructure of [REDACTED] System is composed of two distinct elements: hardware and software.

The equipment or hardware used to provide Purchased Services include both customer owned and [REDACTED] Infrastructure. By agreeing to the CSO the customer agrees to the [REDACTED] Permitted Modifications which allows the [REDACTED] to "change all or any portion of the equipment used to provide the Purchased Services at anytime if the [REDACTED], in its sole discretion, determines such change is necessary or desirable."

Issue

Are the services provided by the Offering non-taxable services or a lease or license of hardware or software?

Applicable Statutes and References

Under Article 5 ("Article") of the North Carolina Revenue Act ("Act")², N.C. Gen. Stat. § 105-164.1 *et. seq.*, Subchapter VIII: Local Government Sales and Use Tax, and Chapter 1096 of the 1967

² References to the Act and North Carolina General Statutes are based on the laws in effect as of the date of issuance of this private letter ruling except as otherwise noted herein.

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Session Laws, State, local, and applicable transit sales and use taxes are imposed on a retailer engaged in business in the State on the retailer's net taxable sales or gross receipts of tangible personal property, certain digital property, and certain services at the percentage rates listed in subdivision N.C. Gen. Stat. § 105-164.4(a) and the applicable local and applicable transit rates of sales and use tax. N.C. Gen. Stat. §§ 105-164.3(23), 105-164.3(65), 105-164.3(77), 105-164.3(123), 105-164.3(195), 105-164.3(223), 105-164.4, 105-164.8, 105-467, 105-468, 105-483, 105-498, 105-507.2, 105-509.1, and 105-537.

Imposed as an excise tax, use tax is levied on the purchase price of "[t]angible personal property purchased, leased, or rented inside or outside [the] State for storage, use or consumption in [the] State" or "[s]ervices sourced to this State." N.C. Gen. Stat. §§ 105-164.3(219), 105-164.3(223), 105-164.3(233), 105-164.3(235), 105-164.6, 105-468, 105-483, 105-498, 105-509, 105-537. The "person who purchases, leases or rents the item" is liable for payment of the use tax. N.C. Gen. Stat. § 105-164.6. "Use" means the "exercise of any right, power, or dominion whatsoever over tangible personal property," including withdrawal from storage, distribution, and installation. N.C. Gen. Stat. § 105-164.3(233).

Under N.C. Gen. Stat. §§ 105-164.4(a)(4c), 105-164.4C(a), 105-164.4C(a1) the "combined general rate" of tax applies to the gross receipts derived from providing telecommunications service or ancillary service. N.C. Gen. Stat. §105-164.3(27) defines the term "combined general rate" as "[t]he State's general rate of tax set in G.S. 105-164.4(a) plus the sum of the rates of the local sales and use taxes authorized by Subchapter VIII of [Chapter 105 of the North Carolina General Statutes] for every county in this State." A telecommunications service that is not sold on a call-by-call basis is sourced to this State if the place of primary use is in this State. An ancillary service is provided in this State if the telecommunications service to which it is ancillary is provided in this State.

N.C. Gen. Stat. § 105-164.4(a)(1)c. applies the general State rate of tax to the sales price of or the gross receipts derived from repair, maintenance and installation services.

N.C. Gen. Stat. §105.164.3(5) defines the term "ancillary service" as "[a] service associated with or incidental to the provision of a telecommunications service. The term includes detailed communications billing, directory assistance, vertical service, and voice mail service. A vertical service is a service, such as call forwarding, caller ID, three-way calling, and conference bridging, that allows a customer to identify a caller or manage multiple calls and call connections."

N.C. Gen. Stat. § 105-164.3(31) defines the term "computer software" as "[a] set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task."

N.C. Gen. Stat. § 105-164.3(35) defines the term "custom computer software" as "[c]omputer software that is not prewritten computer software. The term includes a user manual or other documentation that accompanies the sale of the software."

N.C. Gen. Stat. § 105-164.3(191) provides the term "repair, maintenance, and installation services" "includes the activities listed . . . [below] and applies to tangible personal property, . . . certain digital property, and real property. The term does not include a service used to fulfill a real property contract taxed in accordance with [N.C. Gen. Stat. §]. 105-164.4H. The included activities are:

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- a. To keep or attempt to keep property or a motor vehicle in working order to avoid breakdown and prevent deterioration or repairs. Examples include to clean, wash, or polish property.
- b. To calibrate, refinish, restore, or attempt to calibrate, refinish, or restore property or a motor vehicle to proper working order or good condition. This activity may include replacing or putting together what is torn or broken.
- c. To troubleshoot, identify, or attempt to identify the source of a problem for the purpose of determining what is needed to restore property or a motor vehicle to proper working order or good condition. The term includes activities that may lead to the issuance of an inspection report.
- d. To install, apply, connect, adjust, or set into position tangible personal property or certain digital property. The term includes floor refinishing and the installation of carpet, flooring, floor coverings, windows, doors, cabinets, countertops, and other installations where the item being installed may replace a similar existing item. The replacement of more than one of a like-kind item, such as replacing one or more windows, is repair, maintenance, and installation services. The term does not include an installation defined as a capital improvement under subdivision (21)d. of this section and substantiated as a capital improvement under [N.C. Gen. Stat. §] 105-164.4H(a1).
- e. To inspect or monitor property or install, apply, or connect tangible personal property or certain digital property on a motor vehicle or adjust a motor vehicle. .”

N.C. Gen. Stat. § 105-164.3(201) defines the term “sale or selling,” in part, as “[t]he transfer for consideration of title, license to use or consume, or possession of tangible personal property or certain digital property or the performance for consideration of a service.”

N.C. Gen. Stat. § 105-164.3(203) defines the term “sales price,” in part, as “[t]he total amount or consideration for which an item is sold, leased, or rented,” and specifically includes the retailer’s cost of the property sold, the cost of materials used, labor or service costs, interest, all costs of transportation to the retailer, charges by the retailer for any services necessary to complete the sale; delivery charges; and installation charges.”

N.C. Gen. Stat. § 105-164.3(223) defines the term “tangible personal property” as “[p]ersonal property that may be seen, weighed, measured, felt, or touched or is in any other manner perceptible to the senses. The term includes electricity, water, gas, steam, and prewritten computer software.”

N.C. Gen. Stat. § 105-164.3(151) defines the term “prewritten computer software” as “[c]omputer software, including prewritten upgrades, that is not designed and developed by the author or another creator to the specifications of a specific purchaser. The term includes software designed and developed by the author or another creator to the specifications of a specific purchaser when it is sold to a person other than the specific purchaser.”

N.C. Gen. Stat. § 105-164.3(231) defines the term “telecommunications service” as “[t]he 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 includes any transmission, conveyance, or routing in which a computer processing application is used to act on the form, code, or protocol of the content for purposes of the transmission, conveyance, or

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routing, regardless of whether it is referred to as voice-over Internet protocol or the Federal Communications Commission classifies it as enhanced or value added. The term does not include the following:

- a. An information service.
- b. The sale, installation, maintenance, or repair of tangible personal property.
- c. Directory advertising and other advertising.
- d. Billing and collection services provided to a third party.
- e. Internet access service.
- f. Radio and television audio and video programming service, regardless of the medium of delivery, and the transmission, conveyance, or routing of the service by the programming service provider. The term includes cable service and audio and video programming service provided by a mobile telecommunications service provider.
- g. Ancillary service.
- h. Certain digital property.”

N.C. Gen. Stat. §105-164.13(43) provides an exemption from the sales and use tax imposed by Article 5 of the Act for the sale at retail and the use, storage, or consumption in this State of “[c]ustom computer software and the portion of prewritten computer software that is modified or enhanced if the modification or enhancement is designed and developed to the specifications of a specific purchaser and the charges for the modification or enhancement are separately stated on the invoice or similar billing document given to the purchaser at the time of the sale.”

N.C. Gen. Stat. §105-164.13(43a) provides an exemption from the sales and use tax imposed by Article 5 of the Act for the sale at retail and the use, storage, or consumption in this State of “[c]omputer software that meets any of the following descriptions:

- a. It is purchased to run on an enterprise server operating system. The exemption includes a purchase or license of computer software for high-volume, simultaneous use on multiple computers that is housed or maintained on an enterprise server or end users' computers. The exemption includes software designed to run a computer system, an operating program, or application software.
- b. It is sold to a person who operates a datacenter and is used within the datacenter.
- c. It is sold to a person who provides cable service, telecommunications service, or video programming and is used to provide ancillary service, cable service, Internet access service, telecommunications service, or video programming.”

N.C. Gen. Stat. §105-164.13(43b) provides an exemption from the sales and use tax imposed by Article 5 of the Act for the sale at retail and the use, storage, or consumption in this State of “[c]omputer software or digital property that becomes a component part of other computer software or certain digital property that is offered for sale or of a service that is offered for sale.”

“It is the duty of the Secretary to interpret all laws administered by the Secretary. . . . An interpretation by the Secretary is prima facie correct.” N.C. Gen. Stat. § 105-264.

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Ruling

By agreeing to the CSO the customer allows the Taxpayer and ██████████ to change all or any portion of the equipment used to provide the Purchased Services at the ██████████ sole discretion. A customer's lack of control is shown by the ██████████ retaining possession and/or control of customer owned equipment and the ██████████ Infrastructure. A customer's further absence of control is demonstrated by the limitations placed on the Purchased Services by the ██████████.

Neither the CSO nor the Service Description for the Offering demonstrates a transfer of title, control, or possession of the hardware or other tangible property necessary to provide the Offering, with the possible exception of optional and incidental services. The ██████████ furnishes the necessary materials, labor, and expertise needed to fulfill the Offering. It is the Department's determination that the hardware used to fulfill the Offering, in the absence of transfer of possession or control, is a contract for services and not a sale, lease, or rental of hardware. Possible exceptions, including optional and incidental services are discussed below.

There are instances described within the Service Description for the Offering where possession and control of hardware are assigned to the customer. ██████████ may require a customer to allow the installation of one or more ██████████ owned VPN ██████████ and one or more ██████████ owned monitoring servers into the customer's network. The customer will be responsible for any physical device intervention for devices required to be installed at the customer's location. These devices when located on a customer's premises and requiring physical intervention are demonstrative of possession and control by the customer. If these services are not included in the monthly fee for the Offering and a separate revenue stream is realized from the installation and ongoing service, the Department would consider this a lease or rental of the equipment and sales tax would be applicable. If however, the service and the installation are included in the monthly fee, sales or use tax will be due by the ██████████ on the purchases of tangible personal property used to fulfill the services.

North Carolina taxes the sale of prewritten software delivered either electronically or on a physical medium. North Carolina allows exemptions for custom computer software and certain prewritten software. The seller owned software associated with the Offering is subject to the terms of the Purchased Services. The terms of the agreement, as discussed earlier, do not convey a transfer of possession or control of the software to the customer. The monthly user license fee provides features and services supported by the software application whereby Taxpayer acquires, operates, and maintains the necessary hardware and software. As such, Taxpayer is not licensing software; rather Taxpayer is offering a service.

Taxpayer is offering taxable telecommunications and ancillary services. N.C. Gen. Stat. § 105.164.4(4c) taxes the gross receipts derived from providing telecommunications service and ancillary service at the seven percent (7.00%) general combined rate of tax.. A person who provides telecommunications service or ancillary service is a retailer and must file taxes due on Form E-500E, Combined General Rate Sales and Use Tax Return (Utility, Liquor, Gas, and Other).

This ruling is based solely on the facts submitted to the Department for consideration of the transactions described. If the facts and circumstances given are not accurate, or if they change,

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then the taxpayer requesting this ruling may not rely on it. If a taxpayer relies on this letter ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material aspect from the facts and circumstances given in this letter ruling, the letter ruling will not afford the taxpayer any protection. It should be noted that this letter ruling is not to be cited as precedent and that a change in statute, a regulation, or case law could void this ruling.

Issued on behalf of the Secretary of Revenue
By the Sales and Use Tax Division