

**New York State Department of Taxation and Finance
Office of Counsel
Advisory Opinion Unit**

TSB-A-15(2)S
Sales Tax
April 14, 2015

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S120425A

The Department of Taxation and Finance received a Petition for Advisory Opinion from [REDACTED]. Petitioner asks whether its Cloud Computing product is subject to New York sales and use tax. We conclude that Petitioner's sales of the product are not subject to sales and use tax because the product constitutes a non-taxable service.

Facts

1. Overview

Petitioner's Cloud Computing product offers Internet infrastructure for businesses, which can use it for a variety of purposes, including to run applications for internal purposes (e.g., a "big data" analysis), or to host a commercial website (e.g., an on-line store). Petitioner's Cloud Computing product provides scalable (i.e., readily expandable) computing capacity for customers to execute applications over the Internet. Petitioner's Cloud Computing product is a model of computing in which dynamically scalable computing resources are provided as a service over the Internet. Through Petitioner's Cloud Computing product, customers can run any application that they could run on their own computers, including, but not limited to, gaming software or e-commerce software. In presenting Petitioner's Cloud Computing product, Petitioner's website promotes its scalability, the ease with which additional computing capacity can be purchased and brought on-line, the service's reliability or "uptime," and its security.

As part of Petitioner's product, customers create a virtual server to run specific services and applications by selecting a configuration of memory, CPU, and storage that is optimal for their demands. Petitioner provides this product in units called instances, which constitute hardware and software. Customers access the instances they bought through means of an account. Accounts are assigned encryption keys that customers use to access their instances. Customers retain all intellectual property rights to all data and content that they upload to use in relation to their instances.

"Virtual" in the above paragraph refers to the fact that Petitioner does not identify a specific server for each customer. Rather, when a customer requests a certain amount of computing power, Petitioner decides, through its personnel and systems, what machine or

machines will provide the computing power. As circumstances warrant, Petitioner may designate a different machine or machines to provide the customer's computing power. To supply the necessary computing power, Petitioner generally uses hardware that is known as "multi-tenancy," meaning that many virtual servers can be created from one piece of hardware. Therefore, computing power sold to many different customers could emanate from just one piece of equipment. Occasionally, a customer will request that the customer's computing power come from equipment that is not providing virtual servers to other customers, which is known as a "dedicated instance." Customers have no physical access to the servers providing their computing power and Petitioner does not designate a specific server or other piece of hardware for use by any customer. Customers have the ability to select specific data centers, but not specific equipment within the data center.

2. How Petitioner's Cloud Computing Product Functions

Petitioner makes available to customers a variety of software, data, and other content as necessary for use of Petitioner's Cloud Computing product at no extra charge.

Customers must use some operating system software and/or applications to use the Cloud Computing product. Thus, in purchasing an instance from Petitioner, the customer must use either Petitioner's open-source operating system software ("Open Source Instance"), or a designated third-party operating system software that Petitioner has licensed ("Third Party Instance"). Open Source Instances consist of software that is free to access by anyone, including Petitioner, via the Internet, which Petitioner has optimized for use with its Cloud Computing product. In an Open Source Instance, the software will be accessed for free by Petitioner and offered to customers for no charge. With respect to Third Party Instances, Petitioner will license software from a third-party for use in providing its Cloud Computing product to customers. Petitioner claims that, because of prohibitions in its licensing agreements with third party software providers, Petitioner does not sublicense the software to its customers or permit its customers to download any software. Petitioner does not charge customers separately for the operating system software provided in connection with Third Party Instances. The number of customers that purchase instances running open source operating systems is far greater (by several multiples) than those that purchase instances running a Windows or other proprietary operating system.

Once a customer has requested an instance and specified an operating system (e.g., a "small" or "large" instance running a Linux or Windows operating system) and Petitioner has made it available, the customer can connect with the instance's operating system. Customers can do any of the same administrative functions with the instance's operating system that they could do with an operating system they have running on a physical server located on their own premises, including uploading and installing of a customer's own software. The operating system is the minimum software needed for a customer to be able to run an application using the computing power provided by Petitioner's service. Customers can also use the operating system to search for files they have saved on the instance, create directories, or download files.

Customers may also download free application tools or kits that are used to access and configure their Cloud Computing instance. Petitioner provides users with free software development kits (SDKs). The kits include a library, code samples, and documentation for developers, application programming interfaces (API), a web interface, and a repository for free public data sets. The SDKs give customers the information they need to build programs that will run seamlessly on Petitioner's infrastructure services. An API is a set of commands, functions, and protocols that a programmer can use when building software that will interact with a specific application or operating system. APIs essentially are an instruction manual that tells programmers how to interact with an application. The APIs that Petitioner publishes are commands that allow any program that a customer creates, whether that program is running on a Cloud Computing Instance or outside of Petitioner's computing environment, to interact with Petitioner's data center servers. For example, Petitioner publishes APIs that allow a computer program to request data on Cloud Computing pricing history or to request new Cloud Computing resources (i.e., new instances) from the data center servers. These APIs are listed on Petitioner's website as a free directory. Anyone, customer or not, can see the directory and use the APIs.

Petitioner also makes available to users a console as part of its service. The console is an internet browser based tool that customers use to manage the computing power they have requested (e.g., customers can see details on the instances they have running and request more or fewer instances through the console), and see the accumulating charges for those instances and other services that they may have requested. To use the management console, customers log into their account on Petitioner's website; the web page environment they log into is the management console. A customer can perform all of these same actions by using the free APIs in the directory. The console is simply a web-based tool that uses a graphic user interface to represent those API's. The use of the management console is optional. Many customers use the APIs instead of the free console, while others build their own graphic user interface.

3. Pricing

Petitioner charges customers for Cloud Computing based on hourly rates for the computing resources they consume. Petitioner generally does not charge any fixed fees. Thus, the more advanced the type of CPU, and the greater the amount of memory and storage required by the customer for an instance, the greater Petitioner's charge will be for the instance. The amount of a charge for an instance also depends on the operating system the instance utilizes -- Open Source Instance or Third Party Instance. Third Party Instances that include third party operating system software that Petitioner has licensed for its use may be charged at a higher rate, while Open Source Instances that include other operating system software that Petitioner accesses for free may be charged at a lower hourly rate. Petitioner does not separately charge its customers for use of any software or applications. Petitioner charges solely for providing computing resources. Petitioner also charges its customers a data transfer fee for uploading or downloading data. The data transfer fee is separately stated on the customer invoice. Petitioner is not requesting any opinion on the sales taxability of the data transfer fee.

Customers may use the Cloud Computing product at any time, for any length of time. Alternatively, customers may reserve instance capacity by paying a one-time fee for an instance and receive a discount on the hourly rate.

Analysis

The Tax Law imposes sales and use tax on the retail sale of tangible personal property, including prewritten computer software, and the sale, except for resale, of certain enumerated services. *See* Tax Law §§ 1101(b)(6); 1105(a), (b), (c).

Petitioner's Cloud Computing product allows customers to access computing power -- a specific array of a processor, memory, and storage -- that Petitioner refers to as computer instances. Based on the above facts, and Petitioner's advertising of the product, Petitioner's customers purchase these computer instances in order to run their own software applications. The applications that customers run on Petitioner's Cloud Computing product include data analysis software, intranet software, and e-commerce software.

In purchasing an instance, a customer is provided with an operating system that is necessary for the instance to interact with Petitioner's server network. The operating system represents prewritten software. The customer uses the operating system to perform certain administrative functions, such as to download an application, delete an application, or search for a file. By granting the right to use the third-party operating system, Petitioner is transferring the right to use prewritten computer software within the meaning of § 526.7(e)(4) of the Sales Tax Regulations. However, a customer does not subscribe to Petitioner's Cloud Computing product in order to use the operating system. Rather, it subscribes to the product in order to run an application of its choosing using Petitioner's computing power. This makes Petitioner's Cloud Computing product different from those products where the vendor's transfer of the right to use prewritten software to the customer is what the customer primarily wants from the vendor. *E.g.*, TSB-A-10(28)S (vendor sold customers prewritten software accessible over the Internet that allowed the customers to record their travel expenses). Petitioner's advertising demonstrates that the purpose of its Cloud Computing product is to provide customers with the right to use the computing power to run an application. Petitioner's website emphasizes the scalability of Petitioner's computer power, the ease of accessing it, and its reliability and security. In sum, the transfer of the right to use the operating system software is only an incidental part of the Product, which primarily consists of the sale of Petitioner's computing power.

Similarly, in purchasing an instance, a customer gets the right to use APIs. Customers can use them to interact with Petitioner's servers, in order to perform such administrative tasks as buying additional instances or changing the configuration of an instance, or they can incorporate these APIs into applications to allow the applications to interact with Petitioner's servers. Even assuming that an API constitutes prewritten software, the transfer of the right to use these APIs is an incidental part of Petitioner's Cloud Computing product, the purpose of which is to allow the customer to use Petitioner's computing power to run an application.

Because providing a customer with computing power is not one of the services made taxable by the Tax Law, Petitioner need not collect sales tax on its sales of its Cloud Computing product as described herein. *See* Tax Law § 1105.

DATED: April 14, 2015

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NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion. The information provided in this document does not cover every situation and is not intended to replace the law or change its meaning.