

# Telecom Tax in the Age of “Softwareization”

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# Statement of Purpose

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- **Telecom Tax and “Softwareization”** – Virtualization, including software-defined networking (SDN) and network function virtualization (NFV), is revolutionizing not only how telecommunications are delivered, but also the kinds of services providers can offer. One key implication is that the lines between telecom and internet services are blurring – leaving tax and regulatory considerations in the air.
- In this shifting environment, what will be considered “telecommunications” within the meaning of state tax regimes?
- This panel will consider the impact and ramifications SDN and virtualization are having on the taxability of traditional and emerging telecom services as well as equipment/infrastructure considerations.



# Agenda

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- I. Industry Trends: Overview of Virtualization and Software-Defined Networking (SDN)
- II. Taxation of Telecommunications Hardware and Services: Blurring the Lines of Taxability
  - Changing views on what constitutes telecommunications equipment
  - Data Center Exemption Incentives
- III. Taxation of Telecommunications Software and Applications
  - Software as a Service Business Model (SaaS)
  - Cloud Collaboration Services
  - Virtual Call Center



# What is Virtualization?

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- Virtualization

- The shift from IT physical infrastructure systems to cloud-based, virtual hardware and software solutions.
- Virtualization of software and telecommunications enables more effective automated control of business processes.

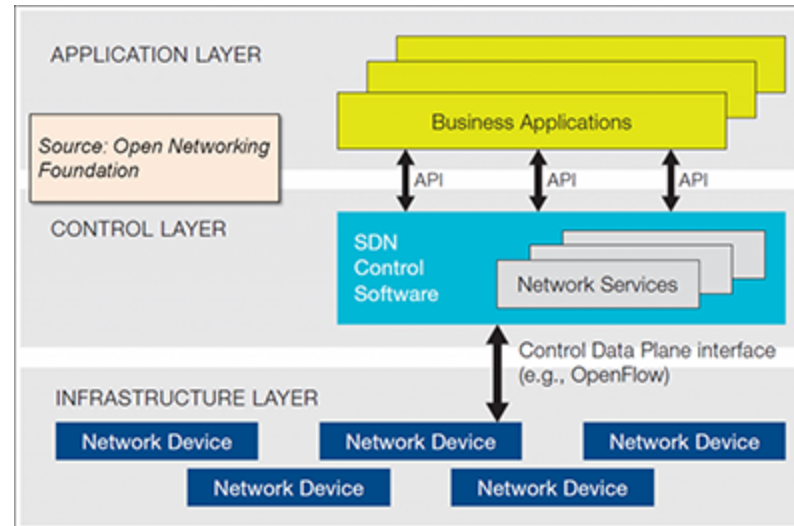
- Forms:

- **Storage virtualization**: the amalgamation of multiple network storage devices into what appears to be a single storage unit.
- **Server virtualization**: the partitioning a physical server into smaller virtual servers.
- **Network virtualization**: using network resources through a logical segmentation of a single physical network.
- **Network function virtualization**: decoupling of network functions from hardware, so they can run in software to accelerate service innovation and provisioning.

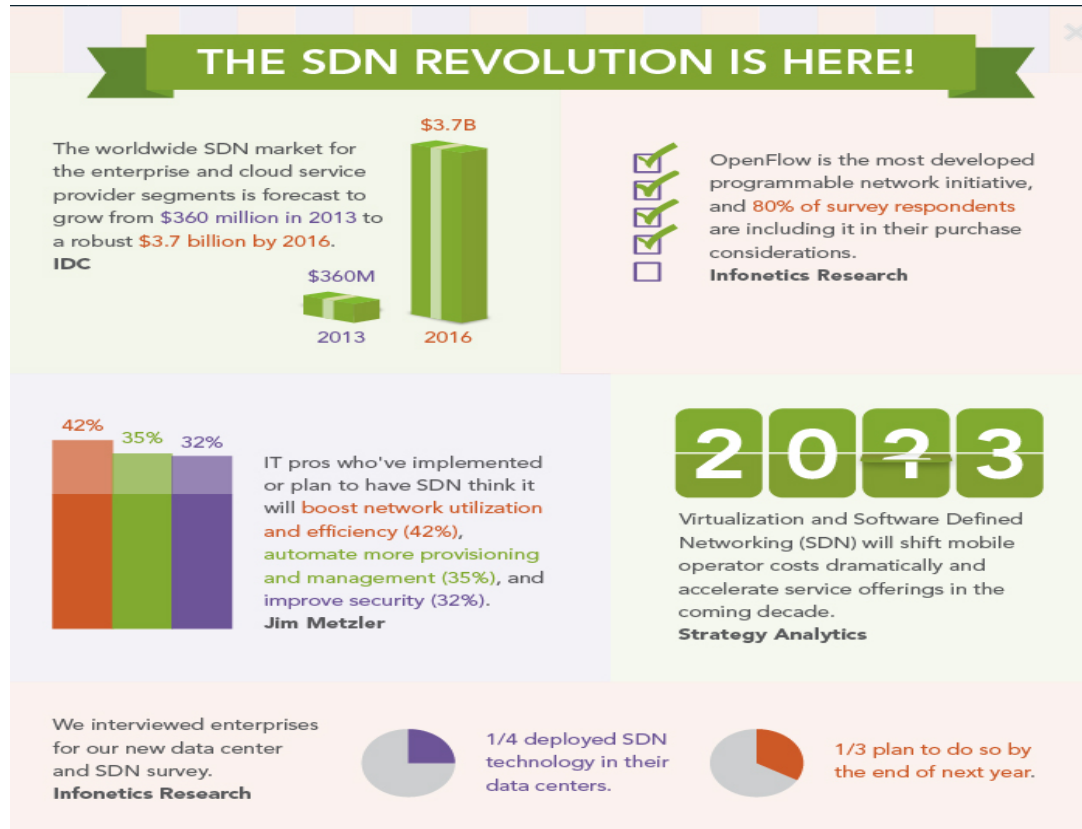


# What is Software-Defined Networking (SDN)?

- Software-defined networking (SDN) is an approach to computer networking that allows network administrators to manage network services through abstraction of lower-level functionality. This provides management, cost, and scalability benefits.
- SDN enables development of software to control the network resources' connectivity and traffic, along with possible inspection and modification of network traffic.



# Shift to SDN Is Happening



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## II. Taxation of Telecommunications Equipment and Services

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- **28 states currently impose some form of sales taxes on wholesale telecommunications equipment purchases.**
  - Specifically charges for installation and maintenance of telecommunications equipment are taxable in some states and nontaxable in others.
    - **Taxable:** See, e.g., Fla. Stat. Ann. § 212.05(e)(1)(c); Okla. Stat. Ann. tit. 68, § 1354(1)(D); Colo. Code Regs. § 39-26-104.1(c); N.Y. Regs. § 527.2(d)(5); Tex. Admin. Code tit. 34, § 3.344(b)(8)
    - **Non-Taxable:** See, e.g., Ala. Code § 40-21-80(a)(11)(vi); Ind. Code § 6-2.5-4-6(c)(1); Ill. Admin. Code tit. 86, § 495.100(b); N.H. Admin. R. Rev. 1602.03(b).



# SDN Impact on Taxation of Transmission Equipment and Services

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- How will states view the content that is sent over wireline and wireless networks?
- Transition from traditional views on what constitutes telecommunications equipment.
- Moving the network into the Data Center.
  - Growth in Data Center incentives.





# SDN Impact on Taxation of Transmission Equipment and Services

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## Ohio

- Telecommunications Service
  - Ohio Rev. Code 5739.01(AA)(1) – 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...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 the service is referred to as voice-over internet protocol service or is classified by the federal communications commission as enhanced or value-added...



# SDN Impact on Taxation of Transmission Equipment and Services

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## Ohio

- Telecommunications Equipment Exemption
  - Ohio Rev. Code 5739.02(B)(34) – Sales to a telecommunications service vendor, mobile telecommunications service vendor, or satellite broadcasting service vendor of tangible personal property and services used directly and primarily in transmitting, receiving, switching, or recording any interactive, one- or two-way electromagnetic communications including voice, image, data, and information, through the use of any medium, including, but not limited to...



# SDN Impact on Taxation of Transmission Equipment and Services

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## New Jersey

- Telecommunications Services
  - NJ Code 54:32B-2(cc) - Electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points. Shall include 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.



# SDN Impact on Taxation of Transmission Equipment and Services

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## New Jersey

- Telecommunications Equipment Exemption
  - NJ Code 54:32B-8.13.c - Sales of telephones, telephone lines, cables, central office equipment or station apparatus, or other machinery, equipment of station apparatus, or comparable telegraph equipment to a service provider subject to the jurisdiction of the Board of Public Utilities or Federal Communications Commission, for use directly and primarily in receiving at destination or initiating, transmitting and switching telephone, telegraph or interactive telecommunications services for sale to the general public.
  - Specific mention of CO and station apparatus equipment.



# SDN Impact on Taxation of Transmission Equipment and Services

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## Washington

- Dark Fiber Optics
  - The Washington State Department of Revenue determined that a telecommunications company’s leases of dark fiber were competitive telephone services and thus subject to retail sales tax. The taxpayer leased dark fiber – unused, unlit fiber optic cable – from various carriers and subsequently “lit” the dark fiber with its own equipment to provide telecommunications services to its own customers. **Wash. Det. No. 13-0172R, 33 WTD 463 (2014).**



# SDN Impact on Taxation of Transmission Equipment and Services

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## New York

- Telecommunications Service
  - New York Reg. 527.2(d) - telephony and telegraphy, telephone and telegraph services includes the use and operation of any apparatus for transmission of sounds, sound reproduction or coded or other signals. However, such services do not include cable television services or music services.



# SDN Impact on Taxation of Transmission Equipment and Services

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## New York

- Telecommunications Equipment Exemption
  - New York Law 1115(a)(12-a) - tangible personal property for use or consumption directly and predominantly in the receiving, initiating, amplifying, processing, transmitting, retransmitting, switching or monitoring of switching of telecommunications services for sale or internet access services for sale or any combination thereof. Such tangible personal property exempt under this subdivision shall include, but not be limited to, tangible personal property used or consumed to upgrade systems to allow for the receiving, initiating, amplifying, processing, transmitting, retransmitting, switching or monitoring of switching of telecommunication services for sale or internet access services for sale or any combination thereof
  - Broad implications of what is considered telecom equipment.





# SDN Impact on Taxation of Transmission Equipment and Services

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## Indiana

### ▪ Telecommunications Services

- Ind. Code 6-2.5-1-27.5 - Telecommunications services are defined as 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.” Shall include 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. Telecommunications services do not include data processing, information services, installation or maintenance of equipment, TPP, advertising, billing and collection services, internet access, radio and television audio and video programming services, ancillary services, and digital products delivered electronically.



# SDN Impact on Taxation of Transmission Equipment

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## Indiana

- **Telecommunications Equipment Exemption**
  - Ind. Code 6-2.5-5-13 - Transactions involving tangible personal property are exempt from state gross retail tax if the property is 1(A) classified as central office equipment, station equipment or apparatus, station connection, wiring, or large private branch exchanges according to the uniform system of accounts (USOA); 1(B) mobile telecommunications switching office equipment, radio, or microwave transmitting or receiving equipment, including, without limitation, towers, antennae, and property that perform a function similar to the function performed by any of the property described in clause 1(A); or 1(C) a part of a national, regional, or local headend or similar facility operated by a person furnishing video services, cable radio services, and satellite television or radio services, or internet access; and...Ind. Code 6-2.5-5-13(2) – The person acquiring the property furnishes or sells intrastate telecommunications services in a retail transaction described in Ind. Code 6-2.5-4-6 or...uses the property to furnish video or internet access services or VOIP services.



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# SDN Impact on Taxation of Transmission Equipment and Services

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## Indiana

- Specific guidelines regarding exemption.
- Must conform to the USOAA standards.
- What about Data Center equipment/software?



# Data Center Exemption: Summary and Qualifications

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## Minnesota

- **What Qualifies? MN Law 297A.68.Subd.42**
  - Purchases of IT equipment and computer software for use in qualified data center made after June 30, 2012.
  - Software Maintenance is exempt after June, 30, 2013
  - Additionally, electricity qualifies for an upfront exemption
- **Investment to Qualify? Effective May 21, 2014**
  - Qualified Data Center - initial build-out of at least 25K sq. ft. while spending \$30M within a 48 month period (Not including land)
  - Qualified Refurbished Data Center - upgrade of at least 25K sq. ft. while spending \$50M within a 24 month period (Not including land)



# Data Center Exemption: Summary and Qualifications

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## Minnesota

- **How to Qualify?**

- Taxpayer must first pay sales tax on equipment and software

- **Length of Exemption?**

- Exemption ends either 20 years from the date of purchase or July, 1, 2042, whichever is earlier



# Data Center Exemption: Summary and Qualifications

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## Missouri

- **What Qualifies? Missouri Senate Bill 149**
  - Purchases of equipment, computers, utilities, including telecommunications and internet services for use in qualified data center made beginning August 28, 2015
- **Investment Amount to Qualify?**
  - New Data Center - New investment of at least \$25M while creating at least 10 jobs with wages of at least 150% of the county average wage over three years
  - Existing Data Center - New investment of at least \$5M over a one year period while creating at least 5 new jobs with wages of at least 150% of the county average wage over a two year period



# Data Center Exemption: Summary and Qualifications

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## Missouri

- **How to Qualify?**

- Taxpayer must apply to the Department of Economics for exemption certification

- **Length of Exemption?**

- New Data Centers - Maximum incentive period of 15 years
- Existing Data Centers – Maximum incentive period of 10 years





# Data Center Exemption: Summary and Qualifications

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## Ohio

- **What Qualifies? Ohio Code 122.175(A)**
  - Purchases of computer data center equipment, including HVAC for the acquisition, construction, expansion, renovation, or repair of a data center
  - Delivery, Installation, or repair of such equipment
- **Investment Amount to Qualify?**
  - \$100M capital investment over a five year period if beginning in 2013, four year period if beginning in 2014, or a three year period if beginning in 2015 or later
  - Taxpayers operating data center must pay annual compensation subject to withholdings to employees of at least \$1.5M each year of the agreement



# Data Center Exemption: Summary and Qualifications

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## Ohio

- **How to Qualify?**

- Taxpayer must apply to the tax credit authority for exemption certification

- **Length of Exemption?**

- Specified term length as stated within the agreement?



# Data Center Exemption: Summary and Qualifications

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## Texas

- **What Qualifies? Texas Code 151.359(a)**
  - Purchases of equipment and computer software for use in a qualified data center
    - Electricity, electrical system, cooling system, emergency generator, mainframe computer, server, data storage, network equipment, rack, cabinet, software, etc
  - On or after September 1, 2013, purchases made beginning on the date the operator is certified as a qualified data center
- **Investment Amount to Qualify?**
  - Capital investment of at least \$200M over a five year period
  - Creates at least 20 qualifying jobs



# Data Center Exemption: Summary and Qualifications

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## Texas

- **How to Qualify?**

- Must apply with the Comptroller for certification and for registration number

- **Length of Exemption?**

- Ten years if capital investment is between \$200 and \$250M
- Fifteen Years if capital investment is at least \$250M



# III. Taxation of Communications Applications

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- Communication functionality over IP networks
- Tax as telecom, TPP, or other service?
- “Cloud Collaboration Service” Rulings
- VoIP Litigation



# “Cloud Collaboration Service” Rulings

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- A “Cloud Collaboration Service”
  - The service routes and augments a customer's voice, video, messaging, presence, audio/web conferencing, and mobile telecommunication capabilities.
  - The service eliminates the need for a customer to maintain independent software and hardware necessary to process and route calls.
- States have made multiple rulings on the same or similar set of facts regarding the taxability of these services.



# Cloud Collaboration - Use of Software/Hardware

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- Taxable sale or lease of the use of software and/or hardware
  - Utah Tax Commission Private Letter Ruling 13-003 (Dec. 4, 2013)
  - New Mexico Taxation and Revenue Dep't Ruling 401-13-2 (Jun. 26, 2013)





# Cloud Collaboration - Telecommunications

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- Taxable telecommunications service rulings:
  - Tennessee Dep't of Revenue Letter Ruling No. 14-05 (Aug. 25, 2014)
  - Virginia Tax Commissioner Ruling 13-182 (Oct. 18, 2013)
  - Colorado Dep't of Revenue PLR-13-006 (Sept. 18, 2013)
  - Kansas Dep't of Revenue Private Letter Ruling P-2013-001 (Jul. 3, 2013)
  - Missouri Dep't of Revenue LR 7248 (May 24, 2013)



# Cloud Collaboration – Other Services

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- Taxable automatic data processing service
  - Ohio Tax Commissioner Opinion No. 14-0001 (Feb. 4, 2014)
- Nontaxable Service
  - Georgia LR SUT-2014-05 (Jun. 9, 2014)
  - Illinois Dep't of Revenue ST 13-0074-GIL (Nov. 26, 2013)



# Virtual Call Center

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- Florida Technical Assistance Advisement TAA 14A19-002 (May 22, 2014)
- Taxability of service allowing call center functionality over internet



# Conclusion

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- Telecom technology becoming part of the cloud
- Consider equipment's purpose
- Analogize communications services
- Accept uncertainty....



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