



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

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providing the Services will be installed on servers located” outside North Carolina. Taxpayer has 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 [REDACTED] located at a [Taxpayer] data center. The [REDACTED] 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 [REDACTED] an IP telephony software application that operates on an IP infrastructure that provides signaling and call control services to [REDACTED] 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, [REDACTED] 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 user [REDACTED] [REDACTED] . . . 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

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[REDACTED]

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well as monitoring and management charges, most moves-adds-changes and major version 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 [REDACTED] 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 [REDACTED] 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 [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] such as the [REDACTED] or larger units. The video support services will be provided by [Taxpayer’s] server through a [REDACTED] [REDACTED] 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 [REDACTED] 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, [REDACTED] Phone, Smartphones, and [REDACTED], among other components.

Presence. Presence support services are provided by [Taxpayer] through a [REDACTED] [REDACTED] application that provides users the ability to determine when colleagues are available. The [REDACTED] 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 [REDACTED] application hosted on [Taxpayer’s] servers to utilize the [REDACTED] capabilities.

Audio Conferencing. With respect to a customer’s audio conferencing capabilities, [Taxpayer] supports a customer-owned [REDACTED] [REDACTED] and the phone devices through its

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hosted [REDACTED] in a manner similar to that which is described above with respect to the voice support services.

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."

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Issue

Are the services provided by the Offering taxable telecommunications service?

Applicable Statutes and References

Under Article 5 (“Article”) of the North Carolina Revenue Act (“Act”)², N.C. Gen. Stat. §§ 105-164.4(a)(4c), 105-164.4C(a), 105-164.4C(a1) “the gross receipts derived from providing telecommunications service or ancillary service in this State are taxed at the . . .” combined general rate.

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(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. N.C. Gen. Stat. §§ 105-164.4C(a1), 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. § 105-164.3(77) defines the term “in this (the) State” as “[w]ithin the exterior limits of the State of North Carolina, including all territory within these limits owned by or ceded to the United States of America.”

N.C. Gen. Stat. § 105-164.3(137) defines the term “place of primary use” as “[t]he street address representative of where the use of a customer's telecommunications service primarily occurs. The street address must be the customer's residential street address or primary business street address. For mobile telecommunications service, the street address must be within the licensed service area of the service provider. If the customer who contracted with the telecommunications provider for the telecommunications service is not the end user of the service, the end user is considered the customer for the purpose of determining the place of primary use.”

N.C. Gen. Stat. § 105-164.3(201) defined the term “sale or selling” 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(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

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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on the form, code, or protocol of the content for purposes of the transmission, conveyance, or 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.”

Ruling

For sales and use tax purposes, North Carolina holds that telecommunications service 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 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. An ancillary service is associated with or incidental to telecommunications service and includes voicemail and vertical services. Vertical services include, but are not limited to, 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.

Based on the information provided, a Taxpayer server, utilizing [REDACTED] communicates with the customer's voice gateway device 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 for supported voice, messaging, audio conferencing, and mobility services. A call is not routed through Taxpayer's server, rather the software instructs the customer's device(s) on how to route or otherwise process the incoming or outgoing call. With respect to video, presence, and web conferencing, the customer uses its own communications equipment to access the [REDACTED] supported applications hosted on Taxpayer's servers.

[REDACTED] and [REDACTED] supported applications are computer processing applications that act on the form, code, or protocol of the content for purposes of the transmission, conveyance, or routing. The software also has functionality allowing for the provision of ancillary services. The functionality that is provided by the Offering meets the definition of a telecommunications service and ancillary service in N.C. Gen. Stat. § 105-164.3.

The argument is made that Taxpayer does not provide the ability to transmit, route information and/or communicate across phone or internet connections. The ability of transmitting and/or routing is provided by the customer's telecommunications provider. Taxpayer provides the

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functionality previously performed by the customer in-house, which was not subject to sales tax. For those reasons Taxpayer concludes the Services do not constitute a taxable telecommunication service.

The logic put forth is that Taxpayer is performing activities previously performed in-house which were not subject to sales tax, therefore the exclusion from sales tax extends to the services provided by the Offering. The argument fails to take into consideration sales tax is a transaction based tax. For a sale to occur there must be a transfer of consideration from one party for an interest in a good or service received from a separate party. In the case where the services are provided in-house, a transaction does not occur between parties. Only when those services are offered for consideration by a separate party is there a transaction; and these transactions may be taxable. With regard to the Services, the customer's provider allows the ability to transmit a signal but the functionality required to direct the signal is provided and replaced by the Services. Taxpayer's Services replace functionality that if provided by the customer's provider would be taxable as a telecommunications service.

The services provided by the Offering meet the definition of telecommunications services and ancillary services and the gross receipts derived from providing telecommunications service and ancillary service are taxable at the seven percent (7.00%) combined general rate of tax. The Offering sales price is calculated on a subscriber basis, subjecting the fee to sourcing based on a flat rate. A flat rate telecommunications service is not sold on a call-by-call basis and is sourced to this State if the place of primary use is in this State. A place of primary use is the street address where the use of a customer's telecommunications service primarily occurs. The street address must be the customer's residential street address or primary business street address.

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, 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