



North Carolina Department of Revenue

Pat McCrory
Governor

Lyons Gray
Secretary

October 30, 2014

Account ID: [REDACTED]
FEIN: [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]

Attention: [REDACTED]

Re: [REDACTED]
Private Letter Ruling Request

Dear Ms. [REDACTED]

We have the Form NC-PLR, Request for Private Letter Ruling, remittance of \$500.00, your letter dated September 10, 2013, and additional information that you provided at the request of the Department over the past months. You have inquired as to your client's North Carolina sales and use tax liability on items offered by your client.

General Information

You advise that your client, [REDACTED] ("[REDACTED]"), "develops, markets, publishes, and distributes game software content and services for video game consoles, personal computers, mobile devices, and the Internet. Currently, [REDACTED] offers games playable on personal computers under the following four models: (1) a downloadable video game that is only playable offline ('Base Model Game'); (2) a downloadable video game that is only playable online (the 'Model 1 Game'); (3) an online game hosted on [REDACTED] website that involves an initial download of software (the 'Model 2 Game') with a subscription option; and (4) a collection of online games that are hosted on [REDACTED] website (the 'Model 3 Game')."

Statutory Authority

N.C. Gen. Stat. § 105-164.4 imposes a sales tax on the retail sale of tangible personal property, certain digital property, and other specified transactions. N.C. Gen. Stat. § 105-164.6 imposes a complementary use tax on items in N.C. Gen. Stat. § 105-164.4 that are purchased inside or outside this State for storage, use, or consumption in this State. N.C. Gen. Stat. § 105-164.3(46) defines [t]angible 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

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term includes electricity, water, gas, steam, and prewritten computer software.” N.C. Gen. Stat. § 105-164.3(4c) defines “[c]omputer 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(29a) defines “[p]rewritten 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. § 105-164.4(a)(6b) provides certain digital property sold at retail and subject to sales and use tax includes an audio work, an audiovisual work, a book, a magazine, a newspaper, a newsletter, a report, another publication, a photograph or a greeting card. N.C. Gen. Stat. § 105-164.3(1f) defines “[a]udio work” as “[a] series of musical, spoken, or other sounds, including a ringtone.” N.C. Gen. Stat. § 105-164.3(1g) defines “[a]udiovisual work” as “[a] series of related images and any sounds accompanying the images that impart an impression of motion when shown in succession.”

Specific Product Details and Taxability Responses

Base Model Game

The Base Model Game “is a video game that may be purchased on [REDACTED] website for a fixed fee and downloaded to the purchaser’s/user’s computer or other device. . . . In order to purchase the game, users must be online and connected to [REDACTED] servers. However, once the game is downloaded to the user’s computer, the game can only be played offline and does not require interaction with [REDACTED] servers. The user has to be online to gain access to the software updates which are delivered electronically and downloaded to the user’s computer or other device.”

Users can also purchase digital content (“Digital Content”) from [REDACTED] website. “When a purchaser purchases Digital Content in the Base Model Game, the user must be online; however, there is no additional download of software. . . . All Digital Content, whether or not purchased, already resides on the user’s personal computer by virtue of the initial purchased download.”

Based on the information provided, [REDACTED] sale of a Base Model Game is the sale of prewritten computer software and is subject to the general 4.75% State and applicable local and transit rates of sales and use tax when sold at retail. Any additional fee or charge a user pays to unlock Digital Content contained in the original downloaded prewritten computer software is the sale of tangible personal property and such amount is subject to the general 4.75% State and applicable local and transit rates of sales and use tax. For purposes of this response, it was determined through conversations with [REDACTED] employees and the client’s representative that the term “Digital Content” used by the client in its ruling request is not certain digital property as contemplated by the imposition of tax in N.C. Gen. Stat. § 105-164.4(a)(6b).

Model 1 Game

The Model 1 Game “requires a download of software from [REDACTED] website for a fixed fee.” The software contains all content and files used to support the game. “However, in order to install, access, and play the multi-player simulated Model 1 Game, the user must be online . . . and connected to [REDACTED] servers, which are located outside of North Carolina.” “Users can also purchase digital content (“Digital Items”) from [REDACTED] website for use in the multi-player game environment. The Digital Items can only be accessed while a user is online and are then

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downloaded to the user's computer. "There is no functionality of the Digital Items without being connected to [REDACTED] servers."

[REDACTED] sale of a Model 1 Game and the sale of a Digital Item for the associated game are sales of prewritten software and subject to the general 4.75% State and applicable local and transit rates of sales and use tax when sold at retail.

Free and Subscription Model 2 Games

The Model 2 Game is "a simulated multi-player game that requires Internet access (not supplied by [REDACTED] at all times to access and play the game. . . . An initial download of software is required to play the game; however, the download is provided free of charge. The Model 2 Game is offered to customers under a free-to-play model (the 'Free Model 2 Game') and a subscription-based model (the 'Subscription Model 2 Game'); the same free download of software is provided to users under both models. The initial free download of software contains all graphic files and content used to support the game and serves as a platform for users to access the Model 1 Game. Although all content and graphic files reside on the user's personal computer through the initial download, [REDACTED] servers store the user's game and host the multi-player environment. Thus, the user can only 'see' and play his or her game through access to [REDACTED] remote servers via the Internet. In addition, [REDACTED] periodically provides free software updates for the Model 2 Game, which is delivered electronically by [REDACTED] servers."

The Free Model 2 Game provides users with restricted access to the Model 2 Game, is only playable online, and is hosted on servers located outside of North Carolina. "The Subscription Model 2 Game provides users with unrestricted access to the Model 2 Game for a monthly fee. No additional software is required to be downloaded under the Subscription Model 2 Game; rather, the same initial download provided without charge under the Free Model 2 Game is used with Subscription Model 2 Game. Once a user subscribes under the Subscription Model 2 Game, [REDACTED] servers communicate with the user's personal computer to 'unlock' the user's account and provide access to the subscriber benefits. Thus [REDACTED] remote servers control a user's access to the Subscription Model 2 Game. The Subscription Model 2 Game is only playable online and is hosted on servers located outside of North Carolina."

Based on the information provided, [REDACTED] sale of a monthly fee for a Subscription Model 2 Game is a sale of prewritten computer software and is subject to the general 4.75% State and applicable local and transit rates of sales and use tax. [REDACTED] has advised that the software provided free of charge is developed internally by [REDACTED] and does not have a purchase price.

Model 3 Game

"The Model 3 Game consists of a collection of online games that does not require users to download any software. . . . The Model 3 Game is only playable online, and Internet access (not supplied by [REDACTED] is required at all times to play." [REDACTED] offers a Free Model 3 Game and a Subscription Model 3 Game.

Users of [REDACTED] Free Model 3 Game and Subscription Model 3 Game are not required to purchase or download any prewritten computer software. Users of these games must access [REDACTED] servers, which are located outside this State, in order to play. [REDACTED] providing access to the Free Model 3 Game and its receipts from Subscriptions to play Model 3 Games online do not represent sales or gross receipts derived from tangible personal property or taxable digital property; therefore, such sales or gross receipts are not subject to North Carolina sales and use tax.

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Virtual Coins

Users of both the Free Model 2 Game and the Subscription Model 2 Game can purchase and redeem virtual currency ("Virtual Coins") from [REDACTED] website. "Virtual Coins have no monetary value and do not constitute currency or property" They can be used in the Model 2 Game to purchase a variety of in-game digital content. "When a user buys a virtual item, there is no additional download of software; instead, [REDACTED] servers provide the user with access to the digital item."

It is the Department's understanding that virtual coins are purchased by a person for a specific game and credit for such coins cannot be transferred to another [REDACTED] game or used by the purchaser outside of the original [REDACTED] game for which such virtual coins are purchased. The sales price of Virtual Coins to a person for a Free Model 2 Game or a Subscription Model 2 Game are subject to the general 4.75% State and applicable local and transit rates of sales and use tax.

Users may also purchase Virtual Coins to use with the Free and Subscription Model 3 Games. "When a user purchases a digital item, there is no new download of software; instead, [REDACTED] servers provide the user's account with access to the digital item." The sales price of Virtual Coins for a Free Model 3 Game or a Subscription Model 3 Game are not subject to North Carolina sales or use tax.

This ruling is based solely on the facts submitted to the Department of Revenue 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 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 ruling, then the ruling will not afford the taxpayer any protection. It should be noted that this document is not to be cited as precedent and that a change in statute, a regulation, or case law could void this ruling.

If you have any questions, you may reach me at the number listed at the bottom of the first page of this letter.

Very truly yours,

[REDACTED]
Administration Officer
Sales and Use Tax Division

[REDACTED]
cc: [REDACTED], Director of Sales and Use Tax Division