SPO ALERT

Date: December 16th, 2016

To: State Agencies and Cooperative Members

From: State Procurement Office

Re: SPO Alert: Tax for Online Library Services

Good afternoon,

SPO has been alerted to recent tax charges on the various Arizona state agency invoices for LexisNexus. These are the result of a decision issued by the Director of the Department of Revenue in October 2015 and released in February 2016 (see the attached Case No. 201400197-S, Arizona Department of Revenue, Director's Review of the Decision of the Administrative Law Judge, October 2015, released February 10, 2016). In that decision the Director concluded that a taxpayer's research library subscription and any other online information services were subject to the Arizona transaction privilege tax under the state and city personal property rental classification.

The description of the tax charge on the LexisNexis invoices is "Tax OL – Online Subscriptions". "OL" is simply an acronym for "online".

Unless your department has a tax exemption, I would advise that this tax is to be paid.

Thank you

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STATE OF ARIZONA

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Douglas A. Ducey
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CERTIFIED MAIL

The Director's Review of the Decision of the Administrative Law Judge Regarding:	)	**O R D E R**
[Redacted]	)	**Case No. 201400197-S**
ID No. [Redacted]	)	

On March 11, 2015, the Administrative Law Judge ("ALJ") issued a decision regarding the protest of [redacted] ("Taxpayer"). The Taxpayer appealed this decision on May 14, 2015. As the appeal was timely, the Director of the Department of Revenue ("Department") issued a notice of intent to review the decision.

In accordance with the notice given the parties, the Director has reviewed the ALJ's decision and now issues this order.

STATEMENT OF CASE

The Transaction Privilege and Use Tax Section in the Audit Division ("Division") of the Department audited Taxpayer for the period of December 1, 2006 through November 30, 2010 ("Audit Period") and determined that Taxpayer had underreported transaction privilege and city tax on personal property rental and retail income. The Division assessed additional transaction privilege and city taxes plus interest ("Assessment"). Taxpayer protested and the matter went to hearing. The ALJ denied Taxpayer's protest and upheld the Division's Assessment.

On appeal, Taxpayer argues that it provides research services and does not rent personal property. The Division argues that the Assessment is proper under the circumstances.

FINDINGS OF FACT

The Director adopts from the findings of fact in the decision of the ALJ and makes additional findings of fact based on the record as set forth below:

1. Taxpayer is a Delaware corporation headquartered in [redacted] that provides research and analysis on [redacted] topics. Taxpayer employs research analysts who write articles and research notes that Taxpayer places in its online database, and Taxpayer offers access to that database through its web portal on a subscription basis.

2. Taxpayer's customers include [redacted], who subscribe to Taxpayer's resources for specific employees such as [redacted]professionals. Only those individuals become "Licensed Users" of Taxpayer's research.

3. A Licensed User may access Taxpayer's research documents on its web portal with a user name and password. The web portal is hosted on Taxpayer's server outside Arizona.

4. Taxpayer refers to its website as a "research library", "portal" or "platform." The website includes a search function, and the information is also organized through categories, labels and priorities set by Taxpayer's personnel.

5. The research articles and notes on Taxpayer's website are not written at the request of any particular customer, and multiple Licensed Users may each access the same article or research note at the same time.

6. Licensed Users may browse information, run searches, and create flow charts and spreadsheets on Taxpayer's website.

7. Taxpayer's contractual agreements with its subscribers include detailed guidelines that limit and restrict the use of Taxpayer's research information. A Licensed User may access and open Taxpayer's research documents on Taxpayer's website and

download one pdf-version of the document only for personal use in the Licensed User's job, but may print only one copy of any document.

8. A Licensed User may not store Taxpayer's content, may not freely share or distribute but only excerpt or reference the content within the subscribing organization, may use a "share" function on Taxpayer's website to share a document only with another Licensed User in the same organization, and must obtain Taxpayer's written approval prior to excerpting or referencing Taxpayer's research outside the subscribing organization.

9. A Licensed User may contact Taxpayer's research analysts to schedule a teleconference and ask specific questions regarding Taxpayer's published research or to apply the research to an [redacted] decision faced by the Licensed User's organization. Some of Taxpayer's subscription packages may also include face-to-face meetings with Taxpayer's research analysts, advisory assistance sessions, workshops or networking options.

10. The Division audited Taxpayer for the Audit Period and determined that Taxpayer was subject to transaction privilege and city tax under the personal property rental classification on its subscription income from Arizona customers. The Division also found some underreported retail sales and over-reported use tax.

11. The Division issued the proposed Assessment, dated March 8, 2013, of additional transaction privilege tax of [redacted] plus interest. No penalties were assessed.

12. Taxpayer protested the Assessment and requested a formal hearing. The ALJ concluded that Taxpayer's provision of access to and use of its research and data content is the leasing of tangible personal property and that Taxpayer's receipts are from personal property rental activity.

CONCLUSIONS OF LAW

The Director adopts from the conclusions of law in the decision of the ALJ and makes additional conclusions of law as follows:

1. Taxpayer is subject to transaction privilege tax under the state and city personal property rental classifications on its research library subscription income.

2. Taxpayer is not entitled to any exemption or deduction from the tax.

DECISION

Taxpayer appealed the ALJ's decision and argues that it does not produce tangible personal property, that its customers do not have exclusive use and control of Taxpayer's platform or the information within it, and that its business activity does not fall under the personal property rental classification. Taxpayer also argues that the Assessment constitutes a new position as compared to the Department's various taxpayer rulings and that the position taken in the Assessment can only be applied prospectively.

The Division argues that Taxpayer leases subscriptions to software and access to articles, that Taxpayer's software and articles qualify as tangible personal property, and that Taxpayer's customers have exclusive use and control of Taxpayer's software when they access the platform and the articles with unique user names and passwords.

The personal property rental classification of A.R.S. § 42-5071 provides:

> A. The personal property rental classification is comprised of the business of leasing or renting tangible personal property for a consideration. . . .
>
> B. The tax base for the personal property rental classification is the gross proceeds of sales or gross income derived from the business.

While there are specific retail exemptions for services rendered in addition to retail sales of tangible personal property, no such exemptions exist under the personal property rental

classification, and Arizona Administrative Code ("A.A.C.") R15-5-1502(D) specifically provides:

> Gross income from the rental of tangible personal property includes charges for installation, labor, insurance, maintenance, repairs, pick-up, delivery, assembly, set-up, personal property taxes, and penalty fees even if these charges are billed as separate items, unless a specific statutory exemption, exclusion, or deduction applies.

Taxpayer provides its customers access to its online research library, a database that the customers can independently browse and where they can run searches for information, download and print articles and create flowcharts and spreadsheets. All these functions are made possible by software that Taxpayer hosts on its server. Whether or not Taxpayer produces that software, the software is tangible personal property and Taxpayer provides the use of it for a consideration.

Taxpayer argues that it mainly provides research services and content, and that the tests applied in *Val-Pak East Valley, Inc. v. Arizona Dept. of Revenue*, 229 Ariz. 164, 272 P.3d 1055 (App. 2012) to draw the taxable line in mixed transactions involving tangible personal property and services should lead to the conclusion that Taxpayer provides nontaxable services and not property. The court in *Val-Pak* expressed two tests for such a distinction of taxable and nontaxable transactions, the "dominant purpose" test and the "common understanding" test:

> As its name suggests, under the "dominant purpose" test, a court decides whether the transaction is all taxable or all nontaxable by identifying the dominant purpose of the transaction.

Id., 229 Ariz. at 167, 272 P.3d at 1058.

> Under the "common understanding" test, whether a mixed transaction is all taxable or all nontaxable is determined by the "common understanding of whether a trade, business, or occupation involves selling products, on the one hand, or rendering services ... on the other."

Id., 229 Ariz. at 168, 272 P.3d at 1059. While there is no evidence of an established "common understanding" of Taxpayer's trade or business as a provider of database access and content, the dominant purpose of Taxpayer's transactions with its customers is to enable database browsing and searching. The customers do not pay for customized research, but for the ability to find the research articles that meet their search queries and to arrange the content as printed text, flowcharts or spreadsheets through the use of Taxpayer's software.

Taxpayer cites *Energy Squared, Inc. v. Arizona Dept. of Revenue*, 203 Ariz. 507, 56 P.3d 686 (App. 2002), where the Arizona Court of Appeals found that an operator of tanning salons was not in the business of leasing or renting tangible personal property based on the level of control it reserved over the use of the tanning beds. Taxpayer argues that its clients never have exclusive use and control of Taxpayer's platform or its information. However, when customers browse, search, print and arrange Taxpayer's content, they control Taxpayer's software to manipulate the presentation of the content. At that point, the customers control the manual operation of their searches, and they generally perform their searches without requiring assistance or guidance from Taxpayer's personnel. Contrary to the tanning bed customer in *Energy Squared,* who "typically knows nothing about how to get what he wants using the taxpayer's equipment,"[1] Taxpayer's customers browse and search Taxpayer's database independently.

Taxpayer also cites *Jones Outdoor Advertising, Inc. v. Arizona Dept. of Revenue*, 717 Ariz. Adv. Rep. 30, 355 P.3d 603 (App. 2015) , a recent decision that involved billboard advertising and the question whether advertising customers were leasing or renting tangible personal property. The court agreed with the billboard owner that the advertisers did not have sufficient control over the billboards for the transactions to constitute "renting" within the meaning of the personal property rental classification. *Id*., 355 P.3d at 605. In contrast to the advertising customers in *Jones Outdoor Advertising*, who could not access or manipulate the billboards that displayed their messages, Taxpayer's customers do

[1] 203 Ariz. at 510, 56 P.3d at 689

access Taxpayer's database and manipulate the presentation and the extraction of content for their specific needs.

None of the decisions by the Arizona Court of Appeals on which Taxpayer relies support its position. While Arizona courts have not addressed Taxpayer's specific line of business, the Colorado Court of Appeals has dealt with the question of whether purchasing the right to access databases on remote servers was subject to use tax, which was levied on certain computer software leased or purchased at retail and over which the buyer had any right, power, dominion, or control. *Ball Aerospace & Technologies Corp. v. City of Boulder*, 304 P.3d 609, 613 (Colo. App. 2012). At issue were online databases that, much like Taxpayer's research library, included technical journal articles and market analysis, and the court quoted the following description:

> "When accessing a commercial database, the customer is ... granted a right to use the database host's computer system and software. For example, when the customer searches for certain material on the host's webpage, he or she is using the host's server and its search engine program."

Id. The court stated:

> Accordingly, we conclude that, by paying to access the online data services, Company purchased the right to use, from a remote location, the computer software contained on the service providers' servers.

Id. As a result, the court held that the purchase of the right to access the databases was subject to use tax. 304 P.3d at 609. The Colorado Court of Appeals' reasoning in *Ball Aerospace* is helpful here. Taxpayer's customers use Taxpayer's software and servers, and they have sufficient use and control when they access and manipulate Taxpayer's content for Taxpayer's transactions to qualify as rental transactions under the personal property rental classification.

Taxpayer's argument that the Assessment constitutes a new position in relation to the Department's various taxpayer rulings focuses on older private taxpayer rulings and overlooks the Department's numerous newer rulings, which address new technologies and

issues such as hosted software applications, internet web portals, web-based platforms and libraries, remote access software arrangements and website hosting, and which explain that such activities may constitute the business of renting tangible personal property in the form of computer software. Moreover, the determinations in private taxpayer rulings are only applicable to the taxpayer requesting the ruling and may not be relied upon by another taxpayer.

Taxpayer is liable for the tax assessed.

ORDER

The ALJ's decision is affirmed.

This Decision is the final order of the Department of Revenue. Taxpayers may contest the final order of the Department in one of two manners. Taxpayers may file an appeal to the State Board of Tax Appeals, 100 North 15th Avenue, Suite 140, Phoenix, AZ 85007 or may bring an action in Tax Court (125 West Washington, Phoenix, Arizona 85003) within sixty (60) days of the receipt of this order. For appeal forms and other information from the Board of Tax Appeals, call (602) 364-1102. For information from the Tax Court, call (602) 506-8297.

Dated this day of October 2015.

ARIZONA DEPARTMENT OF REVENUE

David Briant
Director

Certified original of the foregoing
mailed to:

[Redacted]

Copy of the foregoing mailed to:

[Redacted]

c: Transaction Privilege Tax Appeals Section
Audit Division
Transaction Privilege & Use Tax Audit Section
Office of Administrative Hearings