

Cite as Det. No. 19-0151, 40 WTD 211 (2021)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for Refund of	)	<u>D E T E R M I N A T I O N</u>
	)	
	)	No. 19-0151
	)	
...	)	Registration No. ...
	)	

RCW 82.04.050; RETAIL SALES TAX – PURCHASE OF SERVERS.  
Taxpayer’s sale of digital automated services does not include the resale of the servers (tangible personal property) used to provide digital automated services to its customers. As a consumer of tangible personal property, Taxpayer is required to pay retail sales tax/use tax on the purchase of servers.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Lewis, T.R.O. – Taxpayer, a provider of digital automated services, requests a refund of retail sales tax paid on the purchase of servers used to provide its customers computer-related services. We conclude Taxpayer does not resell the actual servers in its provision of retail services. Finding Taxpayer does not resell the servers, we deny Taxpayer’s refund request.<sup>1</sup>

ISSUE:

Under RCW 82.04.050, is the purchase of a server by a company that provides digital automated services a purchase for resale?

FINDINGS OF FACT:

Taxpayer is a Washington-based business that provides remote access software that establishes a secure and collaborative environment for the development and testing of complex applications by its customers. . . . [Taxpayer describes its services as a cloud platform for providing virtual machine environments.]

On December 22, 2016, Taxpayer’s representative filed a request for refund of \$ . . . in retail sales tax paid on servers purchased during the period January 1, 2012, through December 31, 2012. On March 20, 2017, the Audit Division replied to Taxpayer’s refund request with a “Request for Additional Documentation” letter. The letter stated:

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

We have not received adequate documentation for us to determine whether your application is valid. In order for us to process your refund application, the following information is requested:

Request #1: purchase invoices for servers

Request #2: Any additional documents/information reviewed to complete the refund request argument.

Once we have received and reviewed the information requested, we may request additional documents, electronic equivalents, or other relevant information within the 90-day statutory time period. You have until April 20, 2017, to provide sufficient substantiation.

On May 31, 2017, the Audit Division sent Taxpayer a “Refund Application Denied – Insufficient Documentation” letter. The letter stated:

A letter from us requesting additional information to verify your refund application was sent on March 20, 2017 (see attached). You were given until April 20, 2017, to provide this information.

We did not receive substantiation by the due date and are unable to verify your refund application. Therefore, your refund application is denied, and an audit report will be issued finalizing the Department’s action on your refund application. A copy of WAC 458-20-100, discussing your right to petition for administrative review, is attached.

You may resubmit your refund application for the periods still within statute if you can provide documentation to verify your request.

On December 7, 2017, the Department issued a post-assessment adjustment, to an original audit covering the period January 1, 2011, through September 30, 2014, totaling \$ . . . to Taxpayer.<sup>2</sup> The tax deficiency resulted from two adjustments: 1) an adjustment to income, assessing retailing B&O tax and retail sales tax on certain revenue; and 2) use tax/deferred retail sales tax on the purchase certain items of tangible property.

Regarding the taxation of servers, the audit narrative explained:

The taxpayer representative argues the purchase and leasing of servers is a purchase at wholesale and is seeking a refund of retail sales tax paid on acquiring this equipment. Further the taxpayer representative claims [Taxpayer] is not an end user because it ultimately sells at retail, the remote access software deployed through the servers.

A request for documents to substantiate the resale of servers was not provided and the request for refund of retail sales tax is subsequently denied.

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<sup>2</sup> The \$ . . . post-assessment adjustment consisted of \$ . . . in retail sales tax, \$ . . . in retailing business and occupation (B&O) tax, a \$ . . . credit of service and other activities B&O tax, \$ . . . in use tax, and \$ . . . in interest.

On January 8, 2018, Taxpayer’s representative filed a request for refund of \$. . . of retail sales tax paid on servers for the period January 1, 2012, through December 31, 2012, with the Administrative Hearings and Review Division (“AHRD”). Taxpayer’s request for refund explained:

While it appears that a server is computer “hardware”, servers are devices that include operating systems that perform “services”. Such services may include the ability to reconfigure and update without restart, backup facilities, data transfer, networking capabilities, and security systems. [Taxpayer] purchases the servers for the sale of the operating system services to their customers. The operating system is software. Therefore, the purchase of the servers is the purchase of prewritten computer software.

The servers purchased in transactions that form the basis of this appeal were not used by [Taxpayer] for any purpose other than providing the server operating system to customer. This is the purchase of prewritten software delivered in tangible storage media for resale in the regular course of [Taxpayer’s] business. There is no intervening use by [Taxpayer]. Accordingly, [Taxpayer’s] purchase of servers are excluded from the definition of retail sale and are not subject to Washington sales tax as noted above.

Taxpayer’s January 8, 2018, refund request, page 3-4.

Taxpayer maintains that it resold the servers to its customers. Taxpayer provided the Department with one “Order and Subscription” contract for review. The annual subscription contract was for \$. . . . The contract detailed the “Monthly Application & Capacity Plan” it had with this particular customer as follows:

Number of Users	. . .
<input checked="" type="checkbox"/> Virtual Machines	. . .
Running Networks	. . .
Storage	. . . TB
Public IPs	. . .

The document defined its Virtual Machine as equivalent to a 1 CPU/1 GB RAM computing resource. Taxpayer uses more than one type of server to provide its services. The type of server referenced in the “Order and Subscription” document is a “Virtual Machine.”<sup>3</sup> . . .

Taxpayer disagreed with Audit’s denial of its refund request of the retail sales tax it paid on the purchase [or] lease of the servers. It is clear from Taxpayer’s refund request that it seeks a refund of retail sales tax on server hardware that it purchased or leased. In other words, Taxpayer is seeking a refund of retail sales tax paid on tangible personal property it acquired to provide its services.

. . .

<sup>3</sup> [In general, and for purposes of this determination, a “virtual machine” means a simulation of a computer that runs on a host server.]

## ANALYSIS:

Washington imposes a retail sales tax in Chapter 82.08 RCW. Unless specifically excluded by RCW 82.04.050, the retail sales tax is levied on the selling price of each retail sale of tangible personal property and retail services in this state. RCW 82.08.020. RCW 82.04.050 defines a “sale at retail” or “retail sale” as “every sale of tangible personal property,” but excludes tangible personal property that is purchased “for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person” from the definition of a “sale at retail.” See RCW 82.04.050(1)(a). In this case, Taxpayer purchased [and leased] tangible personal property in the form of computer hardware, specifically servers. However, Taxpayer does not resell [or lease] that computer hardware. Taxpayer, instead, uses the computer hardware to sell digital automated services to its customers.

RCW 82.05.050(8) includes sales to consumers of digital automated services in the definition of a “retail sale.” RCW 82.04.050(8)(a). RCW 82.04.192 and WAC 458-20-15503 (“Rule 15503”) define digital automated services as services transferred electronically that use one or more software applications. The sale of digital automated services is generally subject to retail sales tax. The Department concluded that Taxpayer provides digital automated services to its customers and is required to report the revenue it earns as retail sales. Taxpayer does not dispute that it provides retail-taxable digital automated services to its customers. Taxpayer’s argument is that by providing digital automated services to its customers, it is “reselling” the servers it purchased, so it is entitled to a refund of retail sales tax paid on those servers.

As explained above, to provide the digital automated services to its customers, Taxpayer purchased [and leased] servers, which are tangible personal property. Taxpayer argues that its purchase [or] lease of servers is a purchase for resale and that it erred in paying retail sales tax to the vendor when it purchased [and leased] the servers. Taxpayer maintains it is not the consumer of the servers, because it ultimately sells remote access to the servers, a service that is a retail-taxable sale of digital automated services.<sup>4</sup>

Taxpayer’s sale of digital automated services does not constitute the resale of tangible personal property. Taxpayer did not present to Audit or, on review, to ARHD any documentation to support its claim that it is reselling or re-renting the actual, tangible, servers. Rather, the one document presented to ARHD documented the sale of virtual machines to Taxpayer’s customers. There is no evidence that the provision of virtual machines, which Taxpayer concedes is a digital automated service, constitutes the leasing of server space or a resale of the actual, tangible, equipment. Taxpayer is the user and consumer of the equipment and is required to pay retail sales tax on the purchase of tangible personal property. For Taxpayer to qualify for the retail sales tax exemption

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<sup>4</sup> “Sale at retail” also includes [the sale of] remote access prewritten software as explained in RCW 82.04.050(6)(c)(i) (“[Retail sale] also includes the charge made to consumers for the right to access and use prewritten software, where possession of the software is maintained by the seller or third party, regardless of whether the charge for the service is on a per use, per user, per license, subscription, or some other basis.”). As explained in WAC 458-20-15503(303)(h), remote access prewritten software that is “used in connection with a service that is transferred electronically would generally be included in the definition of digital automated services.” It is possible, in this case, that Taxpayer is selling remote access software that falls outside of the definition of digital automated services. However, as explained above, [the sale of] remote access prewritten software would still be considered a retail sale. For guidance on distinguishing between the two, see WAC 458-20-15503(203)(a)(ii).

for “resale” of the servers, it would have to actually resell the servers “as tangible personal property.” RCW 82.04.050(1)(a)(i). Because it does not resell the actual, tangible, servers to its customers,<sup>5</sup> but instead uses the servers to provide digital automated services to its customers, Taxpayer does not qualify for the “resale” exemption in RCW 82.04.050(1)(a).

DECISION AND DISPOSITION:

Taxpayer’s refund request is denied.

Dated this 5th day of June 2019.

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<sup>5</sup> [Taxpayer presented no evidence that actual ownership, title, or possession of the physical servers was ever transferred from Taxpayer to its customers and, therefore, there is no evidence of a “sale” of the servers to Taxpayer’s customers. *See* RCW 82.04.040(1).]