TAXPAYER INFORMATION RULING LR11-010

June 22, 2011

The Department issues this taxpayer information ruling in response to your request of March 31, 2010, supplemented by your response of May 10, 2010, submitted on behalf of unnamed client ("Company"). You request a determination of the applicability of Arizona transaction privilege tax to the Company's business activities of providing tee time management software and computer hardware.

Statement of Facts:

Your March 31 request provides the following excerpted facts:

> Company is headquartered outside the [S]tate [of] Arizona. . . . Company has two employees who live in Arizona and work in Arizona and in surrounding states. . . . Company has operated in Arizona for a number of years . . . . Company provides a variety of services to golf courses aimed at improving the efficiency of their tee-time reservation process and other aspects of golf course management. To deliver these services, Company provides Arizona customers with proprietary tee time management software and the hardware on which the software will run. Arizona sales tax is paid on the computer hardware that is supplied to customers for their use. . . .

> The contract used by Company lists the services it will provide and the value of the hardware and software it is providing under the service agreement. There is no transfer of title to the property provided to the golf course as a component of the services it provides. All property consumed by Company in providing its service remains on Company's books and is depreciated by Company for financial and tax purposes. There is no transfer of ownership to the equipment or to the software. . . .

> Company also provides telephone reservation services for golf courses under two plans. First is the on-demand reservation service which Company provides when the pro-shop is closed or when the pro-shop is too busy to answer the phone. Second is the full time reservation service where Company answers all of the golf reservation phone calls for the golf course. . . .

> Company also provides a web-reservation service for the golf-courses, lottery tee-time services, email marketing services and training services to customers on how to effectively use Company's services. . . .

> In exchange for the golf course management services Company provides, Company is granted a set number of tee times and cart rentals by their customer. Company calls this an "inventory exchange". . . . The contract used by Company includes the following language that describes the "inventory exchange" program:

INVENTORY EXCHANGE: An inventory exchange program may be presented by Company to the Client as an alternative to the monthly service and/or selected transaction payments, but is not required of Company, and can be denied at the presentation or renewal of the Agreement. Through this option the Client provides Company with a pre-determined amount of tee time inventory in lieu of monthly service and/or selected transaction payments as indicated on the Application for Service. Golfers that purchased their tee times through Company cannot be denied service at the time of their reservation by the Client, and should service not be possible (i.e. inclement weather), it is the responsibility of the Client to provide reimbursement in whatever form is agreed to be acceptable (i.e. rain check) by both the Client and the Golfer(s). The following rules shall apply to the Inventory Exchange Program:

- A tee time shall mean up to four players, including greens fees and carts.
- Unless otherwise agreed upon between Company and the Client, Company may reserve tee times for this program up to 14 days in advance.
- All tee times reserved through this program will be noted on the tee sheet as such.
- If Company, in its sole discretion, deems a tee time "unsold", it will release the tee time back to the Client.
- If Company is unable to secure an allotted tee time due to scheduled outings, events, overseeding, course maintenance, or any other reason beyond Company'[s] control, Company has the right to sell a replacement tee time on a later date. The original date of the tee time will be noted on the replacement reservation.
- The Client will not cancel, move or edit a tee time reserved by Company through this program without first contacting Company.
- The Client will not apply a surcharge to golfers booked through this program which is not charged to regular golfers.
- On any given day, Company has the right to offer one tee time more than its allotment for that day. If Company reserves more than its allotment for a day, it will lower its allotment by that amount on a comparable day. Extra allotments will be noted on the tee sheet. . . .

Company, through its own web-site, markets these tee times and attempts to sell them to prospective golfers. Each tee time is for a specific date and time and will expire if not resold. . . . Once the tee-time has been paid for by the customer, a certificate of payment is provided to them via email and this coupon is redeemed at the golf course for the specific date and time covered by the reservation.

A sample sales contract you provided with your May 10 response contained the following terms and conditions:

A.   DEFINITIONS:
1.   "CSR" refers to a customer service representative working in [a Company] call center.
2.   "Product" and "[Company] Tee Time Network" refer to [Company's] tee time reservation system.

3.   "POS" and "[Company] Point of Sale" refers to [Company's] point of sale software.

4.   "PGC(s)" refers to the golf course(s) participating in the product as a result of the Client's use of [Company].

5.   "Played Round" is any round reserved in the product and not cancelled on or before the intended time of play.

6.   "Third Party(ies)" refers to any party, other than the Client and [Company], using the product to reserve tee times at PGC(s). This may include, but is not limited to, Internet sites, travel agents, golf packagers, and hotels.

7.   "We", "our", "us" and "[Company]" refers to [Company].

8.   "You", "your", "Facility" and "Client" mean the business entity that signs this Agreement providing for participation in the product (the "Agreement").

B.   GENERAL: We will use our best efforts in the performance of this Agreement. Following reasonable advance notice to you, [Company] and any of its partners, principals, employees, or agents, shall be permitted to enter upon any portion of the Client's or its PGC's premises used in connection with [Company] during normal business hours for reasons relating to the maintenance of the [Company] network, software, or hardware. . . .

C.   PERFORMANCE OF THE PARTIES: The parties agree to assume the following rights, duties and responsibilities:

1.   Pursuant to a separate agreement, [Company] shall license each PGC with computer software necessary for the PGC's participation in the product as detailed in this Agreement;

2.   Client shall provide data connectivity as directed by [Company] to access product unless otherwise indicated in this Agreement;

3.   Client shall provide dedicated, isolated and insulated AC power lines for all [Company]-supplied equipment;

4.   Client shall provide any necessary networking within the PGC facility. This work should be completed prior to the installation and training provided by [Company];

5.   Client is responsible for local phone company charges necessary to forward calls to and from [Company]. [Company] is responsible for the long distance telephone charges associated with forwarding calls to [Company] (unless specified elsewhere in this Agreement);

6.   [Company] shall, with the Client or PGC, develop a telephone protocol to be used by [Company] CSRs when answering telephone calls for the PGC; and

7.   Client agrees that its PGC(s) will honor all tee time or other authorized reservations made by [Company] or Third Parties for that (those) PGC(s).

* * * *

E.   SERVICE ENHANCEMENTS: [Company] may perform, design, programming and software enhancements to its service, the product, POS or software applications. Except as otherwise set forth in a written

agreement between the parties, any updates or enhancements provided shall be subject to all other provisions of this Agreement and shall be offered or provided to the Client as appropriate.

* * * *

P.   VOICE RESERVATION OPTIONS: The Client can participate in one of two phone reservation options. The Client can change the selection at any time pending [Company] approval. These options are as follows:

1.   On-Demand Service – phone calls ringing into the Client's PGC will be forwarded to [a Company] CSR only during periods at which the Client selects, when the Client's phones are busy, or when the Client's phone is unanswered after a certain number of rings. The options used are at the discretion of the Client, and are based on the capabilities of the local telephone exchange carrier and the Client's telephone equipment. Various usage options for Staff-On-Demand service may provide optional pricing discounts . . . .

2.   Member Service – the Client chooses for all tee time reservation calls to be handled by [Company] CSRs. Whether or not this service is available to the Client is based on the capabilities of the local telephone exchange carrier and the Client's telephone equipment. Member status may provide optional pricing discounts . . . .Unless specified on the Application for Service, the PGC must a) forward only tee time reservation calls through the use of an "auto-attendant"; or b) publish a toll-free number for tee time reservations (and not forward the PGC's local phone number to such a toll-free number).

Standard Call Center services include:

1.   [Company] CSRs will endeavor to capture golfer data, including mailing address, phone number, and email address.
2.   Phone calls into the [Company] call center will be routed over [a Company]-provided toll free number unless otherwise provided by the Client.
3.   Callers that are in a hold queue will hear a standard recording that alerts them that the "golf shop" will be with them shortly. [Company] may also provide a generic or customized message substantially similar to "We are a member of [Company].com, offering 24-hour reservations through the Internet and [a toll-free number]."
4.   Where established, a tee time confirmation e-mail will be forwarded to the golfer immediately following the reservation.

Q.   POS LICENSE: [Company] hereby grants to Customer a non-exclusive, non-transferable license for Customer and any party authorized to use the POS System ("Authorized User") to use the [Company] Point of Sale System for internal business purposes in accordance with this Agreement. The grant shall be limited to the one facility license as

identified in the Contract Price area of the Products / Services Costs and Fees section.

Customer shall not: (a) sell, lease, sublicense, assign, or provide the POS System to third parties with the sole exception of transfer of ownership; (b) modify, alter, adapt, translate, create derivative works from, reverse engineer, disassemble, decompile or decode the POS System in any way for any reason; or (c) engage in or allow any action that is inconsistent with the terms and conditions of this Agreement or that violates any applicable law.

The following shall remain the sole and exclusive property of [Company]: (a) the POS System (including any enhancements or upgrades thereto, [Company] Materials and all other software and materials developed, conceived, originated, prepared, generated or furnished by [Company] under this Agreement; and (b) all copyrights, trademarks, patents, trade secrets and any other intellectual property and proprietary rights in and to the foregoing (subsections (a) and (b) are collectively referred to as the "[Company] Materials"). Except for the license granted above, Customer shall have no right, title or interest in or to the [Company] Materials.

Upon any termination of this Agreement for any reason, Customer shall: (a) immediately cease using the affected POS System and any other [Company] Materials; (b) return, purge or destroy (as directed by [Company]) all affected POS System and other [Company] Materials and certify to [Company] In writing that all such copies have been surrendered or destroyed in accordance with the foregoing; and (c) pay to [Company] any fees due and owing under this Agreement and/or any Schedule as of the effective date of termination. Moreover, each party shall return or destroy (as directed in writing by the other party) all Confidential Information in such party's possession or under such party's control.

R.   INVENTORY EXCHANGE: An inventory exchange program may be presented by [Company] to the Client as an alternative to the monthly service fees and/or selected transaction payments, but is not required of [Company], and can be denied at the presentation or renewal of the Agreement. Through this option the Client provides [Company] with a pre-determined amount of tee time inventory in lieu of monthly service fees and/or selected transaction payments as indicated in the Inventory Exchange Payment Method section of the Sales Contract. Golfers that purchased their tee times through [Company] cannot be denied service at the time of their reservation by the PGC, and should service not be possible (i.e. inclement weather), it is the responsibility of the PGC to provide reimbursement in whatever form is agreed to be acceptable (i.e. rain check) by both the PGC and the Golfer(s). The following rules shall apply to the Inventory Exchange Program:

- A "tee time" shall mean up to four players, including greens fees and carts.
- Unless otherwise agreed upon between [Company] and the Client, [Company] may reserve tee times for this program up to 14 days in advance.
- All tee times reserved through this program will be noted on the tee sheet as such.

- If [Company], in its sole discretion, deems a tee time "unsold", it will release the tee time back to the PGC.
- If [Company] is unable to secure an allotted tee time due to scheduled outings, events, overseeding, course maintenance, or any other reason beyond [Company's] control, [Company] has the right to sell a replacement tee time on a later date. The original date of the tee time will be noted on the replacement reservation.
- The Client will not cancel, move or edit a tee time reserved by [Company] through this program without first contacting [Company].
- The Client will not apply a surcharge to golfers booked through this program which is not charged to regular golfers.

S.   COSTS AND FEES: By entering into this Agreement, the Client agrees to pay to [Company], upon the Signing Date and thereafter during the term of this agreement, the costs and fees identified in the Contract Price area of the Products / Services Costs and Fees section for any products or services identified as Required. The Client agrees that all fees and costs paid by the Client or the PGC(s) to [Company] as of the Signing Date are non-refundable. The definition of these fees is as follows:

1.   One Time Charges – includes any [Company]-Supplied Hardware, Software, installation and networking of equipment, software or data service(s) needed for the Client or PGC to access the [Company] network, POS and onsite training by [Company] personnel. This does not include in-house wiring at the Client or PGC, installation of basic computer hardware that is supplied by the Client or PGC. The Client is responsible for networking of the Client's PCs.

2. Monthly Service – includes access to the [Company] Tee Time Network, two user licenses (additional user licenses may be obtained), use of the 24-hour [Company] Golf Call Center, 24-hour Technical and Software Support, software upgrades, promotion of the Client or PGC by [Company] and [Company] partners if applicable, and upgrades to [Company] networking equipment and data circuit if deemed necessary by [Company]. The monthly service will be invoiced (as applicable) at the end of each month for service the following month. Billing shall begin upon installation (the "Service Date").

3. Transaction Fees – transaction fees may vary depending on the originating source of the tee time transaction as well as the volume of tee times played during the specified month. A billable transaction is one in which a golf round is booked via the [Company] Tee Time Network and is not cancelled. There is no charge for transactional entries made into product by the Client or PGC at terminals onsite. Transaction Fee types and charges are detailed in the Contract Price area of the Products / Services Costs and Fees section.

4. Additional Costs – any costs incurred by [Company] resulting from changes made by the Client that directly affect the [Company] Tee Time Network (i.e. moving a data circuit into a new clubhouse) will be billed back to the Client in full.

5. Additional Products & Services – additional products and services that are selected by the Client and added to the Client's monthly service invoice which do

not appear on the Products / Services Costs and Fees section or an Addendum, will be priced and billed for the effective amount at the time they are selected. Such additional services may include, but are not limited to, additional training, custom reports, custom database requests, fee maintenance (beyond the first 90 days of this Agreement), and the setup of non-standard reservation capabilities (e.g. instructors). Should the Agreement be extended or rewritten, the pricing for those added services may be adjusted pending prior notification to the Client by [Company].

T.   TERM: This Agreement shall be effective on the Service Date and continue for the length of time denoted on the Application for Service. Unless terminated as provided herein, the Agreement will renew for additional one-year periods unless canceled by written notice by the Client or [Company] to the other party thirty (30) days prior to the anniversary of the signing date of the Agreement.

* * * *

V.   [COMPANY]-PROVIDED EQUIPMENT: Unless specified in the Sales Contract, any equipment or hardware we provide to you is our property. Title, ownership and right to possession of the equipment listed in the Contract Price area of the Products / Services Costs and Fees section shall remain with [Company] until all sums due are paid or depreciation provisions are fully met. [Company] warrants that upon delivery, the equipment shall be in good working order. After delivery, all risk of loss or damage to the equipment from fire, water, storm, burglary, power line fluctuations, spillage, accident, negligence, or abuse shall be borne by Customer.

W.   [COMPANY]-PROVIDED   EQUIPMENT/SOFTWARE/SERVICES REIMBURSEMENT: [Company], at their sole discretion, may agree to provide hardware, software or services, normally requiring a One Time charge, as part of an inventory exchange payment option. All hardware, software or services included in this provision will be noted with a cost in the Equipment & Products Repayment area of the Products / Services Costs and Fees section of this Agreement. These items will be covered by the follow[ing] provisions:
1.   All included Equipment/Software/Services will be depreciated over the term of agreement with equipment becoming property of the facility at end of term.
2.   If Client changes method of payment to "cash" before end of original term, facility will owe the undepreciated amount of "Equipment & Products Repayment Total".
3.   The original amount of the Equipment & Products Repayment Total for this Agreement is $9,695.40[.]
4.   Client is responsible for any and all property taxes assessed on the hardware detailed above.
5.   The Client represents that it maintains insurance sufficient to cover any potential loss or damage up to the full value of all hardware provided by [Company] as detailed above.

X.   PAYMENT CONDITIONS: Client's Installation fee is due at contract signing. All other payments are due within thirty (30) days of invoice. . . .

When the Client or PGC(s) authorizes [Company] to collect fees directly from Golfers or Third Parties, these fees will be collected at the time of reservation or as soon as possible thereafter. [Company] will remit amounts due to the Client or the PGC to the appropriate party on a monthly basis after first deducting any outstanding [Company] balance, interest or late fees owing to [Company], and any applicable credit card charges, fees and expenses. The Client will be solely responsible for the payment of any tax[es], surcharges or fees assessed by any state or local government.

A separate promotional document, entitled "Providing Software and Services to the Golf Industry," provides the following details about Company's software suite:

Electronic Tee Sheet Software
- Golf industry's premium tee sheet, operated by hundreds of courses worldwide
- Analytic tools to manage customer data, tee sheet utilization, and more
- Marketing and email tools to increase sales
- Personalized email confirmations (HTML) sent for all reservations
- Personalized "reminder" and "thank you" email messages
- Course data accessible by 3rd party partners – hotels, sister courses, golf packages

Reservation Center
- Ensure your calls are answered 24 hours a day, 7 days a week
- Never miss another tee time call again
- [A]gents capture your customers' data – address, phone, zip code, email
- Enhance customer service by eliminating phone calls from your golf shop
- Forward phone calls to [Company] at night, when line is busy, or after three rings

Point of Sale Software
- Fast and easy to learn – Touch screen technology with customizable "hot buttons"
- High-speed credit card processing, integrated with tee sheet for rapid check-in
- Barcode inventory management, reward/loyalty programs and gift cards
- Customer receipt design and cart rental agreements
- Package/kit items combine SKUs for fast and easy check-out
- Remote administration and central reporting

Online Tee Times
- Enable your Web site for online tee times 24 hours a day, 7 days a week
- Offer last minute tee times and online bookings in emails to your customers
- Manage tee times using your custom policies and rates

Support and Service
- 24x7 unlimited support and service included at no additional cost
- Dedicated Account Manager assigned to your facility

- Onsite training as well as remote training

   Preconfigured Hardware and Software
- Preconfigured hardware and support from industry leader Dell Corporation
- Includes server, two workstations, POS peripherals with 3-year service agreement

   Email Marketing and Course Web Sites
- Email Marketing Service
- Custom HTML templates, Database management
- Follow up reports; open emails, clickthru tracking
- Course Web Sites
- Content management, Web 2.0 look and feel
- Online tee times, surveys, ecommerce, event signup

   Flexible Pricing
- Multiple payment options, including receiving all products and hardware for no cash
- Exchange unsold tee times for all products and services, or
- Monthly service fee

A promotional document explaining the Inventory Exchange program provides the following description:

[Company] Offers Flexible, No Cash Payment Option

The [Company] Inventory Exchange payment option makes it possible for your facility to install and use every . . . product and service without paying cash.

. . . This unique payment option allows most courses to bring in the complete suite of [Company] products and services, as well as hardware, without having to remit payment.

[Company] will work very closely with your facility to take tee times that do not interfere with your prime booking periods. The goal of the program is to take tee times when your course is not 100% full.

Inventory Exchange → Calls answered 24 x 7 x 365 / Full use of all Software & Services / Complete Hardware Package → DRIVE More Rounds and Revenue / DELIVER Better Cus[t]omer Service / MANAGE Your Facility More Efficiently

Marketing Benefits

* * * *

Your golf course will co-own the golfer data that is captured for all inventory exchange tee times.

A promotional document explaining the Tee Time Network provides the following description:

> **Key Features**
> - Access your tee sheet from any PC with Internet access
> - Search and reserve tee times across multiple days or courses
> - Customize your pricing formats for different types of play
> - Reserve and track your golfer categories with custom settings
> - Manage multi-course facilities or 27-hole operations with ease
> - Drag-n-Drop or Copy-n-Paste between days and/or courses
> - Send automated email tee time confirmations to your golfers
> - Build shotguns, split-tees, squeeze times and any other design
> - Apply multiple membership restrictions
> - Track Check-Ins and No-Shows
> - Send out automated "Reminder" and "Thank You" emails
> - Build pop-up screens to alert your staff of course bulletins
> - Create and manage events and outings
> - Restrict access to some features based on various security levels
> - Use color-coding to identify special tee time slots
> - Create and track multi-reservation golf packages
> - Track utilization and forecast future revenues
> - Preview or export reports to track rounds, revenue, and golfers

Your Issues:

You raise the following paraphrased issues in your request:

1. Are Company's gross receipts derived from golf course management and consulting services subject to Arizona transaction privilege tax?
2. Are Company's gross receipts derived from reselling the tee-times subject to Arizona transaction privilege tax under the amusement classification?[1]

Your Positions:

Company's positions are as follows:

1. Company is not subject to transaction privilege tax on its gross receipts from golf course management and consulting services, as they constitute nontaxable services exempted under Arizona Revised Statutes ("A.R.S.") § 42-5061(A)(1).

---

[1] Although your original request asks whether Company's gross receipts derived from tee-time sales are subject to Arizona use tax, Company, as the vendor, is not the taxpayer for use tax purposes, and thus cannot receive a ruling from the Department on the matter. *See* A.R.S. § 42-2101 (private taxpayer rulings and taxpayer information rulings are issued to taxpayers and potential taxpayers). Nevertheless, gross receipts derived from sales of amusements are generally not subject to Arizona use tax, insofar as they do not involve the sale of tangible personal property purchased from a retailer or utility business and used, stored, or consumed in this state. *See* A.R.S. § 42-5155(A).

2. Company is not subject to transaction privilege tax under the amusement classification on its gross receipts from selling tee times because it does not operate or conduct an amusement activity. Rather, it is compensated for services it provides by a barter transaction involving the "inventory exchange" of tee times.

Discussion:

Transaction Privilege Tax Imposed Under the Retail and Personal Property Rental Classifications

Products sold, leased, or rented as part of a business's taxable activities under the retail and personal property rental classifications are not limited to "physical goods," but rather, need only constitute "tangible personal property." Arizona's broad definition of tangible personal property is "personal property which may be seen, weighed, measured, felt or touched or is in any other manner perceptible to the senses."[2]

The tax base for the retail transaction privilege tax is limited to the gross receipts derived from the business of selling tangible personal property "at retail." Retail sales are those "for any purpose other than for resale in the regular course of business in the form of tangible personal property, *but transfer of possession, lease and rental as used in the definition of sale mean only such transactions as are found on investigation to be in lieu of sales as defined without the words lease or rental*."[3] Transfers of possession, leases, and rentals are instead generally subject to transaction privilege tax under the personal property rental classification

The personal property rental classification comprises "the business of leasing or renting tangible personal property for a consideration."[4] While there are specific retail exemptions for professional or personal service occupations or businesses and for services rendered in addition to retail sales of tangible personal property, no corollaries exist under the personal property rental classification. Arizona Administrative Code ("A.A.C.") R15-5-1502(D) underscores this discrepancy between classifications in stating, "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."

The taxability of a vendor's gross receipts derived from any sale of tangible personal property (*i.e.*, sale at retail, lease, or rental) made under the retail and personal property rental classifications is unaffected by whether the vendor's customers allow subsequent use of that property by parties other than the users licensed by the vendor. Under such circumstances, the only means by which taxability would be impacted is if: (a) vendor

---

[2] A.R.S. 42-5001(16).
[3] A.R.S. § 42-5061(V)(3) (emphasis added).
[4] A.R.S. § 42-5071(A).

delivers the tangible personal property to purchasers or lessees for use exclusively outside the state or (b) the vendor's customers make subsequent retail sales or leases of the property, such that the initial transactions between the vendor and its customers constitute non-taxable sales for resale.[5]

Hosted Software Applications

Under the traditional model, prewritten (canned) software has been sold at retail as "shrink-wrap" or "click-wrap" licenses, wherein a customer buys a license from a software producer or third-party retailer to use the software and installs it locally (*e.g.*, from a CD-ROM or electronically-transferred package of files) on hardware belonging to or under the control of the customer; the software producer may subsequently provide support to the customer as dictated by the software license agreement or a separate software support agreement.[6] The Software-as-a-Service ("SaaS") model of software delivery to consumers is one in which a vendor hosts the application software (*i.e.*, stores the software application code on the vendor's servers or servers owned by a third party remote from the customers' premises), and customers access them over a network, typically the Internet using a web-based user interface.[7] Customers do not own the software licenses but, rather, pay on a subscription basis (*e.g.*, on a per-application or usage basis) for using them.[8]

"Cloud" (*i.e.*, Internet-based) computing often involves, as a component, a "cloud application," one that exists partially or fully online. One example is the SaaS application described above, wherein software is not installed and run locally, reducing the need for localized software maintenance, deployment, management, and support.[9] Because such offerings are typically subscription-based, they reduce or amortize the immediate

---

[5] *See* A.R.S. §§ 42-5061(V)(3) (taxable activity of "selling at retail" excludes selling for resale) and 42-5071(C) (sales of tangible personal property to be leased or rented to a person engaged in a leasing or rental business are deemed sales for resale).

[6] *See, e.g.*, Frederick Chong & Gianpaolo Carraro, *Building Distributed Applications: Architecture Strategies for Catching the Long Tail*, MICROSOFT DEVELOPER NETWORK, Apr. 2006, http://msdn.microsoft.com; H. WARD CLASSEN, SOFTWARE LICENSING FOR LICENSEES AND LICENSORS 199-200 (3d ed. 2009).

[7] R. KELLY RAINER JR. & EFRAIM TURBAN, INTRODUCTION TO INFORMATION SYSTEMS 358 (2009); Chong & Carraro, *supra* note 12; CLASSEN, *supra* note 6, at 143 (use of a third parties to manage and maintain software under "managed hosting" model). It has been observed that, from a terminology standpoint, "SaaS has superseded Application Service Provider (ASP) and "Utility Computing" as the industry's preferred name for purchasing software on a service basis." CLASSEN, supra note 6, at 143.

[8] RAINER & TURBAN, *supra* note 7, at 358; Gianpaolo Carraro & Fred Chong, *Software as a Service (SaaS): An Enterprise Perspective*, MICROSOFT DEVELOPER NETWORK, Oct. 2006, http://msdn.microsoft.com; Chong & Carraro, *supra* note 6; CLASSEN, *supra* note 6, at 144. Note that, although the focus of the discussion is on the managed hosting model, wherein third parties are responsible for managing and maintaining customers' hardware and software, there are also "collocation" models where customers own all hardware and software and the third party merely provides a space, power, Internet connection, and basic monitoring ("power, pipe, and ping"). *See* CLASSEN, *supra* note 6, at 147.

[9] Darry Chantry, *Mapping Applications to the Cloud*, MICROSOFT DEVELOPER NETWORK, Jan. 2009, http://msdn.microsoft.com; CLASSEN, *supra* note 6, at 143-44.

front-end costs that are commonly associated with acquiring prewritten software licenses (*e.g.*, software and hardware costs, technical support, update fees, time to install and manage software).[10] Another example is a Software plus Services ("S+S") model, a hybrid between traditional application development and SaaS wherein "rich client" applications are installed locally on a user's personal computer as an interface to externally hosted applications.[11] Such offerings may be provided directly from a vendor or by a third-party intermediary called an aggregator, which bundles SaaS offerings from different vendors and offers them as a single package.[12]

The term "license," as used in the retail software sale context, has been described as "something of a technicality" because "legally, the customer is only purchasing the right to use a copy of the software, but for practical purposes, it's as though the customer 'owns' the software and may use it as often and for as long as it wishes."[13] Contrastingly, with an SaaS model, "instead of 'owning' important software outright, customers are told, they can pay for a subscription to software running on someone else's servers, software that goes away if they stop subscribing."[14]

The intuitively understood benefits of the cloud computing business model have been summarized in the following fashion:

> By eliminating much of the upkeep, and using the economics of scale to combine and centralize customers' hardware and services requirements, SaaS vendors can offer solutions at a much lower cost than traditional vendors, not only in monetary terms, but also by greatly reducing the need for customers to add complexity to their IT infrastructure. This gives SaaS exclusive access to an entirely new range of potential customers that have always been inaccessible to traditional solution vendors, because it has never before been cost-effective to serve them . . . .[15]

In instances where software vendors offer cloud computing offerings, programs are often reconfigured to meet certain end-user needs; such activities are distinguishable from actual software customization, in that vendors will reconfigure the software's metadata to change the way an application appears and behaves for a particular customer.[16] Cloud computing users may use browser or rich Internet application (*e.g.*,

---

[10] CLASSEN, *supra* note 6, at 28, 143-44.

[11] Chantry, *supra* note 9.

[12] *See* Carraro & Chong, *supra* note 8. This article also discusses the varying degrees to which programs can be partially or wholly reliant on SaaS-based architecture in usage (*e.g.*, when locally-run software depends in part on data produced by a SaaS application).

[13] Chong & Carraro, *supra* note 6. Such software is commonly known as "shrink-wrapped" software in the industry.

[14] *Id.* at 23-24; Chong & Carraro, *supra* note 6.

[15] Chong & Carraro, *supra* note 6.

[16] *See, e.g.*, *id*. The term "metadata" is often defined as "a definition or description of data," wherein users or information systems professionals can configure how data is displayed or otherwise manipulated for end users without any change in the software code base. *See id.*; Dick O'Meara & Beverly Reeder, *Meta*, SEARCHSQLSERVER.COM, Nov. 7, 2005, http://serachsqlserver.techtarget.com.

thin client client-server model applications) as a kind of gateway or interface to allow them to access the applications.[17]

For purposes of Arizona transaction privilege tax, the Department does not consider a license of tangible personal property the same as a taxable lease or rental. A software license, however, is dissimilar to arrangements that fall under the general "license" nomenclature used for leases and rentals of physical tangible personal property (*e.g.*, property that can be touched or felt). As discussed, virtually all sales of prewritten software are sales of nonexclusive rights to use, regardless of whether they are sold on physical media or transmitted electronically or whether they have perpetual or limited terms.[18] Because of the interplay of federal copyright laws and the differences in the meaning of the terms "sale" and "license" as used in the federal Copyright Act[19] compared to common law applications used in Arizona tax law cases,[20] a software license should not be confused with the common law concept of license. Tax treatment is based upon the rights that arise from a particular contractual arrangement; merely relying on how the arrangement is labeled can be misleading.

Separate Lines of Business Analysis

Although the Company does not explicitly address the subject in its ruling request, whether the Company is solely acting as a lessor of tangible personal property or is also engaged in a separate line of business of providing nontaxable golf course management and consulting services affects how its gross receipts attributable to these respective business activities are treated for transaction privilege tax purposes.

The Arizona Supreme Court has stated that "[i]f activities are incidental in the sense that they are inseparable from the principal business and interwoven in the operation thereof to the extent that they are in effect an essential part of the major business, they cannot be taxed as a separate business."[21]

Determining whether a taxpayer has more than one line of business requires evaluating the relevant facts and circumstances pursuant to a three-part test established by the Supreme Court in *State Tax Commission v. Holmes & Narver, Inc.*[22] The *Holmes & Narver* test provides that whether activities constitute a separate business depends on if: (1) the portions of the separate activities can be readily ascertained without

---

[17] Carraro & Chong, *supra* note 8. For more discussion of rich Internet applications, *see Rich Internet Application (RIA)*, SEARCHSOA.COM, Sept. 25, 2007, http://searchsoa.techtarget.com; Kathy Chung et al., *Thin Client*, SEARCHNETWORKING.COM, Mar. 23, 2006, http://searchnetworking.techtarget.com; Thomas Li, *Application Program Interface*, MICROSOFT EXCHANGE, Feb. 16, 2004, http://searchexchange.techtarget.com.

[18] For additional discussion on the rare occasions that exclusive software licenses are sold, *see* CLASSEN, *supra* note 6, at 27.

[19] 17 U.S.C. § 101 et seq.

[20] *See, e.g.*, CLASSEN, *supra* note 6, at 19.

[21] *Trico Electric Coop., Inc. v. State Tax Comm'n*, 79 Ariz. 293, 297, 288 P.2d 782, 784 (1955).

[22] 113 Ariz. 165, 548 P.2d 1162 (1976) (en banc).

substantial difficulty, (2) the amounts attributable to the activities in relation to the taxpayer's total taxable Arizona business are not inconsequential, and (3) the activities cannot be said to be incidental to the taxpayer's principal (taxable) business.[23] If the relevant facts and circumstances fail to satisfy the three-prong test, all gross proceeds or gross income would be merged into the taxpayer's principal business. If the facts and circumstances meet the three prongs, however, the activities would exist as a separate line or lines of business, and taxpayer's gross proceeds or gross income would be subject to tax under the appropriate tax classification for each line of business.

Ruling:

Based on the facts and documentation provided, the Department rules as follows:

1. Company is engaged in the business of leasing tangible personal property in the form of prewritten software and computer hardware, and is thus subject to transaction privilege tax under the personal property rental classification on its gross receipts from activities associated with leases to Arizona customers. To the extent that Company derives gross receipts separately attributable to golf course management and consulting services, such gross receipts would be included in the tax base for the personal property rental classification, as explained in A.A.C. R15-5-1502(D), unless Company can show that it is engaged in a separate line of business of providing these nontaxable services.

    Company's gross receipts derived from software leased to out-of-state lessees, to out-of-state persons (e.g., using the software exclusively outside the state), or to persons leasing for resale or re-lease are deductible under A.R.S. § 42-5071. Under any other circumstances, the taxability of Taxpayer's leases to Arizona customers is unaffected by whether such customers allow subsequent use of the property by parties other than the users specifically licensed by Taxpayer.

2. Company is not subject to transaction privilege tax under the amusement classification on its gross receipts from selling tee times under the inventory exchange program because it does not operate or conduct an amusement activity. Rather, its gross receipts from the inventory exchange program are generally subject to tax under the personal property rental classification, as described in paragraph 1 above.

This private taxpayer ruling does not extend beyond the facts presented in your letters and enclosed documents of March 31 and May 10, 2010.

This response is a taxpayer information ruling (TIR) and the determination herein is based solely on the facts provided in your request. The determinations are subject to change should the facts prove to be different on audit. If it is

---

[23] 113 Ariz. at 169, 548 P.2d at 1166.

determined that undisclosed facts were substantial or material to the Department's making of an accurate determination, this taxpayer information ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law, or notification of a different Department position.

If the Department is provided with required taxpayer identifying information and taxpayer representative authorization before the proposed publication date (for a published TIR) or date specified by the Department (for an unpublished TIR), the TIR will be binding on the Department with respect to the taxpayer that requested the ruling. In addition, the ruling will apply only to transactions that occur or tax liabilities that accrue from and after the date the taxpayer receives the ruling. The ruling may not be relied upon, cited, or introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the taxpayer information ruling. If the required information is not provided by the specified date, the taxpayer information ruling is non-binding for the purpose of abating interest, penalty or tax.

Lrulings/11-010-D