

Cross-border Cloud Computing: The State / International Tax Debate

Carolynn S. Iafrate Kranz
Industry Sales Tax Solutions

Jim Nason
Deloitte Tax LLP

Stacey Sprinkle
Verizon



Agenda

Understanding the Landscape – What are “cloud” based services?

Why does it matter?

- Selling it – what is it and how should it be taxed?
- Buying it – how are you using it in your business and what are the tax ramifications based on how the services are defined?
- Becoming it – what are the ramifications of these services to business?

U.S. tax policies compared to International tax policies

- Transaction tax purposes
- Income tax purposes

Understanding the Landscape – What are “cloud” based services?

What are you selling / buying?

- Tangible personal property
- Software
- Service
- Digital Good
- Something else

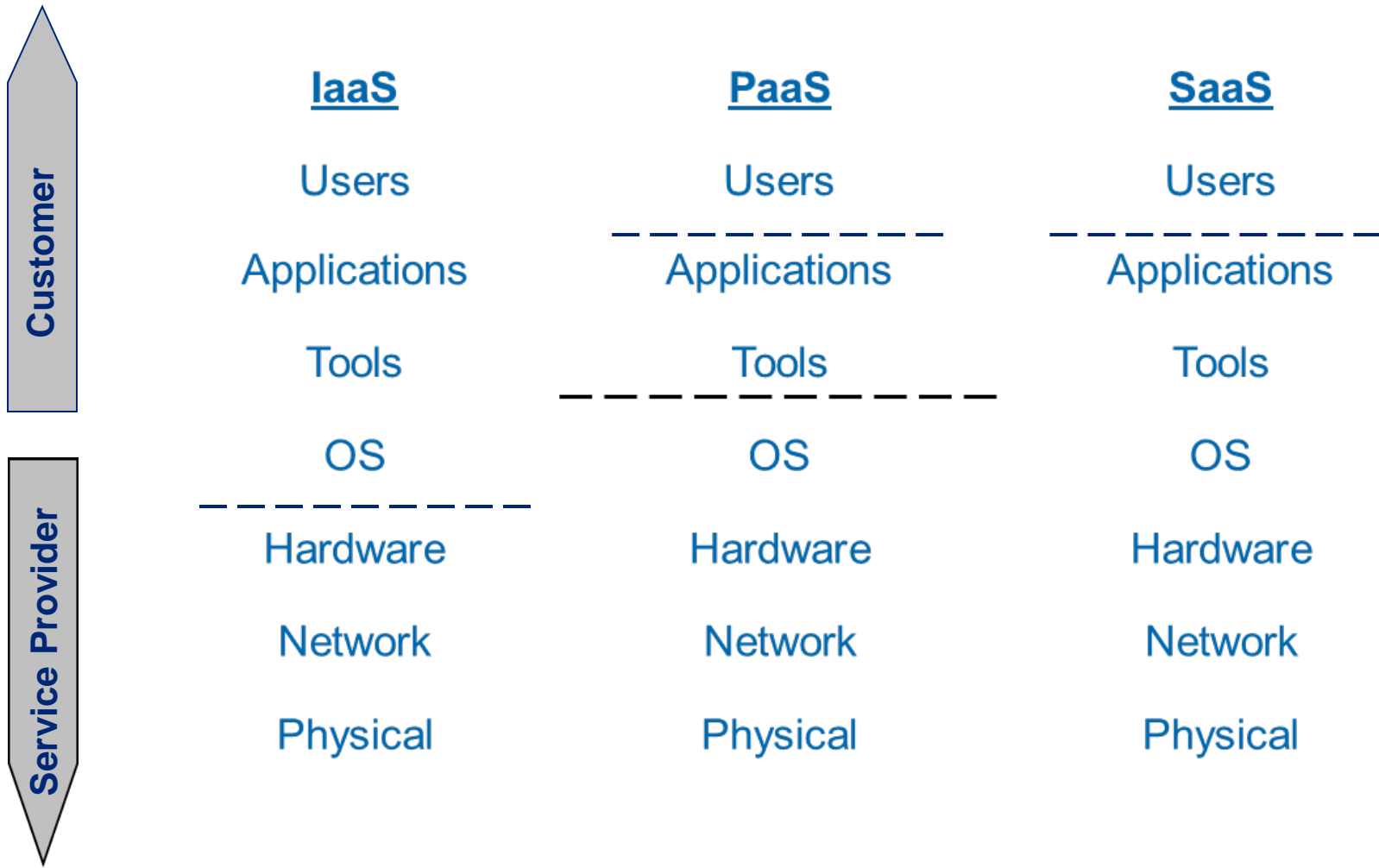
How is it being delivered?

- Tangible form
- Electronically delivered
- Electronically accessed
- Electronically streamed

Tax Ramifications driven by -

- What the product/service is defined as
- How the product/service is delivered

Cloud Services - Division of Ownership



----- Indicates separation between Provider and Customer

Benefits behind use of new technology models






Cloud Computing Benefits

- Cost savings and efficiency
- Businesses no longer need to expend their limited resources on purchasing and maintaining costly computer hardware and software
- Limits IT costs associated with managing computer hardware and software resources

Significant growth in cloud services market and cloud services revenue

Cloud computing services are the tip of the iceberg - technology & innovation continue to spawn new features, services, platforms and business models

Certain key areas where technology innovation is taking place

Smart Devices	Mobility	Cloud Computing	Analytics	Data Security
 <ul style="list-style-type: none">▪ Examples: Smart home devices, wearable tech▪ Devices are becoming miniaturized and more affordable▪ The trend is away from “all-in-one” devices to those that meet specific needs▪ The focus is now on more ‘personal’ applications	 <ul style="list-style-type: none">▪ More devices are enabled with both portability and connectivity▪ The mobile device is finding application as the controller of other devices▪ With ‘Bring-Your-Own-Device’ (BYOD) trends, the focus is on device management to app management	 <ul style="list-style-type: none">▪ Over 50% of IT spending over next 2 years is on cloud▪ Cloud is being used to help drive business agility and speed to market▪ Cloud provides a common innovation platform for Mobile, Social and Big Data▪ Cloud enables the analysis/dissemination of data for IOT	 <ul style="list-style-type: none">▪ Data visualization and dashboards is making analytics more accessible and driving adoption▪ Data from smart devices is now being collected and monetized▪ Predictive analytics is helping businesses be more proactive in driving decision-making	 <ul style="list-style-type: none">▪ Security investments are dramatically increasing, driven by increased regulation and increased focus on privacy/controls▪ Security as a Service is being driven by more users accessing cloud services from mobile▪ Hybrid cloud model is helping meet more stringent SLAs

Some metrics behind “cloud” based goods & services – representing significant growth to the economy

- Mobile Apps
- Digital Music
- Digital Apps Downloaded
- e-books



What are the tax ramifications for the cloud / digital economy? Buy or Sell?

National trends –

- An area of increasing focus for state and local governments as the economy continues to migrate from sales/purchases of tangible goods to sales/purchases of cloud/digital based goods and services
- Streamlined Sales and Use Tax Agreement (SSUTA) – How does the SSUTA agreement treat the sales of cloud/digital based products and services?
- Pending Federal Legislation – Digital Goods and Services Tax Fairness Act – how does the Act treat the sale of cloud/digital based products and services?
- National Conference of State Legislatures (NCSL) - Executive Committee task force on State and Local Taxation – what is their role and focus in the tax rules applicable to the new economy?
- Organization for Economic Cooperation and Development (OECD) – What is their focus on the tax rules applicable to the new economy? Base Erosion and Profit Shifting (BEPS) proposal

What are the tax ramifications for the cloud / digital economy?

Selling cloud/digital based services –

- How are the sales “sourced” to know which tax jurisdiction is entitled to tax the sale of the cloud/digital based products and services?
- Classification of product/service does matter, specifically ownership rights to what is being purchased
- How the product/service is delivered to the customer does matter in determining taxability and sourcing of the sale
- What does the contract specify that you are selling? Auditors and courts often heavily rely on the contractual language in characterizing the item being purchased. If a software license agreement is executed, it will be difficult to argue that you are not licensing software
- Invoice and marketing materials of what is being sold are also increasingly being relied upon to determine the nature of what is actually being sold
- Are there differences in sourcing for income tax versus transaction tax purposes?

What are the tax ramifications for the cloud / digital economy?

Purchasing cloud/digital based services –

- How are the purchases being “sourced” by the seller to identify which tax jurisdiction is entitled to tax your purchase of a cloud/digital based product or service?
- Can you defer having the seller assess sales tax on the sale and self remit use tax on your purchase of cloud/digital based products and services?
- Again, classification and delivery of the cloud/digital based product or service will be critical in determining taxability and sourcing of the purchase – focus, specifically for software, is on where the product or service is being “used”
- Similarly, contracts, invoices and marketing materials will continue to be relied upon to determine the nature of what is being purchased
- Are there differences in sourcing for income tax versus transaction tax purposes on the buy side of the equation?

What are the tax ramifications for the cloud/digital economy?

Streamlined Sales and Use Tax Agreement (SSUTA) –

- Defines “prewritten computer software” as tangible personal property, although states can separately chose to exempt prewritten computer software altogether or based upon how it is delivered to the customer
- Defines “specified digital products” and products “transferred electronically” separate and apart from the definition of computer software, ancillary services, telecommunication services and tangible personal property
- Sources the sale/purchase of such products to where the products are “received” by the purchaser
- “Receipt/receive” is defined as taking possession of tangible personal property, making first use of services or taking possession or making first use of digital goods, whichever comes first
- Project is currently considering “clarifying” that “remote access software” is taxable as prewritten computer software and seeking to modify sourcing to the location of the user, not where the software resides

What are the tax ramifications for the cloud / digital economy?

Pending Federal Legislation: Digital Goods and Services Tax Fairness Act (DGSTFA) –

- Defines digital good as “any software or good that is delivered or transferred electronically including sounds, images, data, facts, or combinations thereof, maintained in digital format, where such good is the true object of the transaction rather than the activity or service performed to create such good”
- Defines digital service generally as “any service that is provided electronically, including the provision of remote access to or use of a digital good”
- Sources the sales to the customer’s “primary use” location which is defined as “the street address representative of where the customer will primarily use the digital good or service” – this is a proxy location and not a requirement to track actual use
- Allows one-time transactions to be sourced to the customer address on file versus soliciting “primary use” location
- Provides for customer “direct pay” alternative

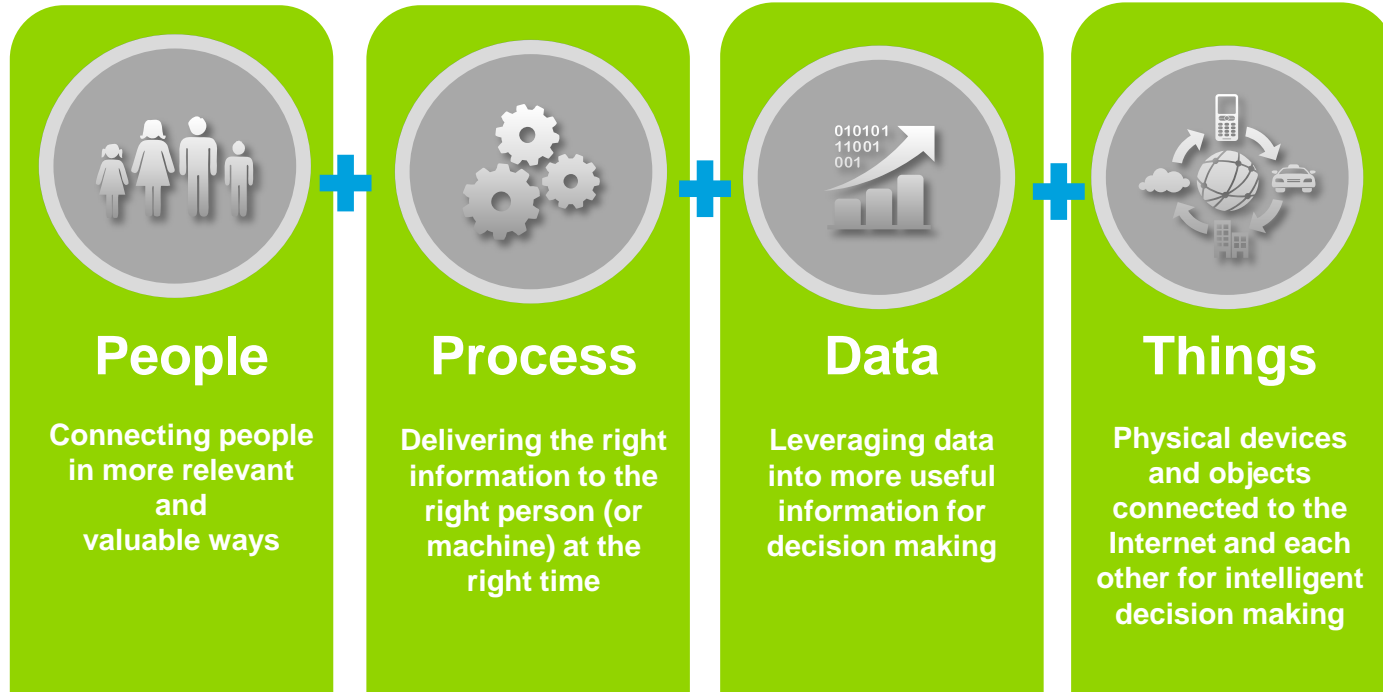
What are the tax ramifications for the cloud/digital economy?

Organization for Economic Cooperation and Development (OECD) plan on Base Erosion and Profit Shifting (BEPS) –

- Action 1 of the Action Plan calls for work to address the tax challenges of the Digital Economy
- Defines the digital economy as “several varieties of e-commerce, on-line payment services, app stores, on-line advertising, cloud computing, participative networked platforms and high speed trading”
- Project has identified that cross-boarder trade in goods, services and intangibles creates challenges for VAT collection, particularly where such products are acquired by private consumers from suppliers abroad
- The framework guiding work in this area is based on the tax principles of neutrality, efficiency, certainty and simplicity, effectiveness and fairness, flexibility and sustainability
- The project is focused on both direct and indirect taxes seeking to align taxation with economic activities and value creation




What does the future hold?




Technology shift enables companies to Turn Data into Insight, Action and New Business Models Through Ubiquitous Connectivity



Advances in a number of related technologies, including sensors, analytics, network, cloud, security and M2M management platforms, are allowing companies across industries to illuminate their “dark” assets. They can collect, analyze, share and act on the data to drive operational efficiencies or new growth models in new ways.

TMT Enabled Business Models...

Category	Sample Applications
Consumer & Commercial Telematics 	<ul style="list-style-type: none"> Fleet management – GPS, vehicle diagnostics, fuel monitoring, driver performance Accident assistance, concierge services, navigation, remote vehicle access, infotainment Representative business models: Telematics Waze
Home Automation 	<ul style="list-style-type: none"> Security – Alarm system monitoring, video surveillance, intrusion detection Smart appliances – Energy consumption control, inter-appliance communication Representative business models: Nest ADT Pulse Honeywell Z-Wave
Manufacturing Automation 	<ul style="list-style-type: none"> End-to-end material management, inventory and tracking management Operators efficiency Product quality management Representative business models: IOT Connected Factories

Category	Sample Applications
Health Monitoring 	<ul style="list-style-type: none"> Hospital/ clinic asset management, supply chain optimization Patient location and condition tracking, medication administration EKG body sensors, diabetes monitoring Representative business models: fitbit Apple watch IBM/Watson
Retail & Vending 	<ul style="list-style-type: none"> Retail: cashless payment, mobile point of sale, checkout line optimization, on-shelf availability, mobile customer promotions, supply chain Vending: Real time stock information, monitoring cash collection, remotely diagnose/ repair issues Representative business models: Amazon eBay Alibaba Google Shopping Express
Smart Grid & Utilities 	<ul style="list-style-type: none"> Smart grid networks – import/ export electricity, monitor loads, control production/ infrastructure, bidirectional grid control Smart meters – measure energy consumption, adjust operations Representatives business models: AT&T Edison Smartconnect Smart meter utility companies

Source: Forrester (2011), Deloitte analysis. Other categories not listed here include Insurance, Education, Wholesale Trade and Government

Contact Information

Carolynn S. Iafrate Kranz

cskranz@industriysalestax.com

Jim Nason

jnason@deloitte.com

Stacey Sprinkle

stacey.sprinkle@verizonwireless.com

APPENDIX

Significant Industry Trends - Terminology

Cloud	<p>Cloud Business Models are proliferating disrupting global tax structures</p> <p>Margins are eroding on sales of tangible property as customers move to consumption based services models</p>
Big Data	<p>Geometric volume increases in structured and unstructured data create issues and opportunities</p> <p>Rapidly expanding sources of data including multiple ERP systems for acquisitive companies and unstructured data for cloud and other activities are giving rise to risk and opportunity for tax</p>
Mobility	<p>Mobility is creating new paradigms for where, how and when work is getting done</p> <p>Challenges and opportunities for tax exist in nexus, permanent establishment, and other areas</p>
Social	<p>Social media is redefining the way people connect and consume information</p> <p>Fundamental transformations of business models across multiple sectors are giving rise to tax issues and opportunities</p>
Analytics	<p>Cloud, Big Data, Mobility and Social are all opening the door to powerful analytics</p> <p>From historical to predictive to prescriptive, enterprises are just scratching the surface in understanding the possibilities</p>

This presentation contains general information only and the respective speakers and their firms are not, by means of this presentation, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This presentation is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. The respective speakers and their firms shall not be responsible for any loss sustained by any person who relies on this presentation.