March 25, 2021

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RE: Sales Tax - Sale of License of Software-Defined Wide Area Networks
        Opinion No. 20200903

Dear ██████ :

I am writing in response to your recent request for a revenue legal opinion:

> The Company sells a cloud-based Software-Defined Wide Area Networking service ("SD-WAN" or the "Service") to customers throughout the United States. The SD-WAN features include internet optimization and redundancy to better ensure uninterrupted internet usage, accomplished by cloud-based software which monitors and reports on customers' internet service provider ("ISP") performance, applies the customer's unique - quality of service ("QoS") policies, and directs customer internet traffic based on real-time usage and diagnostics.

> QUESTION

> Does the Company's SD-WAN software application Service fall under the definition applicable to a nontaxable Software as a Service ("SaaS")? If not, is there any other taxable service under which the Company's Service would fall? …

> BACKGROUND AND DISCUSSION

> *SD-WAN Overview*

> The Company's SD-WAN is delivered as a managed internet optimization service that is consumed by its customers (who are mainly businesses) in a fashion similar to cloud-based services (a.k.a. software as a service or "SaaS"). Customers purchase the

Company's Service based upon bandwidth/throughput needs, in packages such as 100Mbps. Customers primarily pay for the SD-WAN Service as a monthly recurring fee.

The following elements are required in order for customers to connect to the SD-WAN software application:
1) Customers must maintain service with at least one ISP (i.e. ████ or ████ for example), as the Company's Service does not provide any underlying physical internet or WAN connectivity
2) Customers must connect a Company-provided router to their internet connection(s)
3) A designated internet protocol address block ("IP Address") is provided by the Company.

Hardware Rental/Lease

Customers are provided with a pre-configured router for a one-time, non-recurring setup and rental fee, payable at the time the customer submits its order for Service. This hardware is generally shipped to the customer via a common carrier service or USPS.

Generally, the Company owns and retains title to the routers, switches, and/or other hardware delivered to the customer. The Company has concluded that this temporary transfer of hardware is a rental subject to sales and use tax.

IP Address Block

As part of the Service, the Company provides customers with an IP Address block for use during the term of the subscription. Each IP address is a numerical label assigned to a device connected to a network that uses the IP address for communication. The Company-provided IP Address block is a static IP Address that doesn't change when internet traffic is moved between different ISP connections. It is tunneled (similar to how a Virtual Private Network tunnels traffic) over the customers' underlying internet circuits, to enable seamless failover between redundant circuits.

Depending on customer requirements, a customer may also rent additional IP Address blocks from the Company. The Company has concluded that the rental additional of IP Address blocks does not fall under any specified taxed service and is therefore not subject to sales or use tax.

SD-WAN Software Application

The Company's SD-WAN software application Service provides customers with the following:

1) Monitoring - The software embedded in the router is in constant communication with the software embedded in the Company's remote network servers to monitor the characteristics of the network connections. This continuous monitoring measures latency (the time that [it] takes for the data to travel across the network to its destination), jitter (variance in latency across the network), packet loss (data does not make it to its final destination due to faulty cables, strained bandwidth, software problems, and so on), and capacity.
2) Actions - Based on the information gathered in the monitoring process, the software on each end of the connection will re-route and prioritize the internet traffic to ensure uninterrupted internet usage.
3) Visibility - The Company's software aggregates all data collected in the monitoring process and stores it in the cloud. This data is made visible to the user via the Company's ███ ████████.
4) Control - The user can change settings via the ███████ ████████ to adjusts QoS policies, load balancing rules, and other software application settings.

As outlined above, the SD-WAN software application allows customers to monitor their ISP performance and apply pre-defined policies to help prioritize and manage Internet traffic. For example, a customer may run three cloud-based applications at the same time (████████████████████████). The SD-WAN software application will apply pre-defined policies and prioritize bandwidth usage based on the importance level of the application. In this example, ████ would have the highest priority, ██████ second, and ██████ last. Depending on the amount of bandwidth available and currently in use, ██████ may run slower or may not be accessible if the customer's pre-defined policies set within the SD-WAN software application, along with the continuous system monitoring, indicate that there is not enough bandwidth to support the application.

Furthermore, when a customer has more than one ISP, the SD-WAN software application performs load-balancing of traffic by directing

packets from tunnels running over one ISP to tunnels running over another ISP when the monitoring process identifies issues in a network connection.

The Company's centralized multi-tenant web-based dashboard provides customers with visibility into the health of their internet connections. The dashboard allows users to troubleshoot WAN or internet issues, evaluate bandwidth/speed adjustments, and understand the impact of network performance. Customers may view this information in summary or drill down by location. They can view bandwidth usage, latency, internet loss over time, circuit capacity, and condition alarm levels based on historical data or real-time data. In addition, customers may also receive real-time email alerts if any of their internet connections decreases in quality or has an outage.

RESPONSE

The Company's SD-WAN software application Service, as described by your letter, would not be subject to Arkansas sales and use tax.

Discussion

The Arkansas Gross Receipts (Sales) Tax is generally applicable to the sale of tangible personal property and certain enumerated services. Ark. Code Ann. § 26-52-301 (Supp. 2019). The tax is computed based on the total value of consideration paid for the taxable property or service. *Id*.; *see also* Ark. Code Ann. § 26-52-103(19) (Supp. 2019). When a sale of tangible personal property or the performance of such an enumerated service occurs in Arkansas, a taxable transaction occurs, and the tax should be collected and remitted. Arkansas Gross Receipts Tax Rule GR-5. A "sale" means any transaction resulting in the transfer of either the title or possession, for … valuable consideration, of tangible personal property or taxable services regardless of the manner, method, instrumentality, or device by which such transfer is accomplished. Arkansas Gross Receipts Tax Rule GR-3(M)(1).

Arkansas Compensating (Use) Tax is due on the purchase of any tangible personal property that is purchased out of state and brought into Arkansas for use, storage, consumption, or distribution. Ark. Code Ann. § 26-53-106 (Supp. 2019). "Use," with respect to tangible personal property, means the exercise of any right or power over tangible personal property incident to the ownership or control of that tangible personal property. Ark. Code Ann. § 26-53-102(30)(A) (Supp. 2019). The compensating use tax is assessed when the transportation of the property has come to rest or when the property has become commingled with the general mass of property in the state. Ark. Code Ann. § 26-53-106(b) (Supp. 2019); *see also Martin v. Riverside Furniture Corp*., 292 Ark. 399, 401-02, 730 S.W.2d 483, 485 (1987). Once the transportation has ceased or the property is commingled, the property is no longer in the stream of interstate commerce and is subject to the

compensating use tax. *See Martin*, 292 Ark. at 402, 730 S.W.2d at 485; *see also Skelton v. Federal Express Corp.*, 259 Ark. 127, 131, 531 S.W.2d 941, 94 (1976). There is a presumption that tangible personal property shipped, mailed, expressed, transported, or brought to this state by a purchaser was purchased from a vendor for storage, use, distribution, or consumption in this state. Ark. Code Ann. § 26-53-106(d)(2) (Supp. 2019).

Sales of services are not taxable in Arkansas unless the service is specifically enumerated by statute as a taxable service. Thus, if a specific service is not listed in a tax imposition statute, it is not taxable. Arkansas Code Annotated §§ 26-52-301 *et seq.* enumerate taxable services. *See also* Arkansas Gross Receipts Tax Rule GR-9.

From the information you supplied, it appears that the Company's customers do not receive the software in any tangible form and merely operate the software online. The Arkansas Code does not specifically enumerate the service of allowing access to, and use of, software over the internet as a taxable service subject to Arkansas sales and use tax. Consequently, Arkansas sales tax does not apply to the Company's SD-WAN software application Service described in your opinion request.

I have based this opinion on my understanding of the facts as set out in your inquiry and as current Arkansas laws and rules govern those facts. Any changes in the facts or law could result in a different opinion. Because you did not identify the Company when you requested this opinion, this opinion is not binding on the Department. In accordance with Arkansas Gross Receipts Tax Rule GR-75, the Department is issuing this opinion for general information purposes only.

A copy of the Arkansas Gross Receipts Tax Rules referenced in this letter is available online at http://www.dfa.arkansas.gov/offices/policyAndLegal/Documents/et2008_3.pdf.

Sincerely,

Brad Young, Attorney
Revenue Legal Counsel