**Opinion Letter**

|  |  |
| --- | --- |
| **Letter Number:** | **O-2010-005** |

|  |  |
| --- | --- |
| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Kansas sales tax as applied to application service providers (ASP's).** |
| **Keywords:** |  |
| **Approval Date:** | **06/22/2010** |

**Body:**

Office of Policy & Research

June 22, 2010

XXXX
XXXX
XXXX

RE: Your e-mail dated January 20, 2010

Dear XXXX:

Thank you for your recent e-mail. You have been unable to locate Kansas Information Guide EDU-71, *Sales Tax Guidelines: Taxing Charges for Computer Products and Services and Internet Related Sales and Services,* on the department's web site. Please be advised that EDU-71 was rescinded by the department and removed from the department's policy library. EDU-71 contained statements that were imprecise or inconsistent with the requirements of the Kansas sales tax law. Other sections of EDU-71 correctly state the law.

The department is in the process of revising EDU-71 and hopes to have a revised version published this summer. Please note that while EDU-71 has been rescinded by the department, it is still published on tax databases such as CCH or RIA. If you have a specific question about how Kansas sales tax applies to computer software, please submit it to the department in writing and we will answer it. You cannot rely on the rescinded version of EDU-71 for answers to any of your questions.

You also ask how the department treats ASP providers. The department has issued a number of letter rulings that state that ASP services are not subject to Kansas sales tax.

As with many evolving computer-based services, there is no universal definition of ASP services. Wikipedia provides the following discussion of ASP services:

An application service provider (ASP) is a business that provides computer-based services to customers over a network. Software offered using an ASP model is also sometimes called On-demand software or software as a service. (SaaS). The most limited sense of this business is that of providing access to a particular application program (such as customer relationship management) using a standard protocol such as HTTP.

The need for ASPs has evolved from the increasing costs of specialized software that have far exceeded the price range of small to medium sized businesses. As well, the growing complexities of software have led to huge costs in distributing the software to end-users. Through ASPs, the complexities and costs of such software can be cut down. In addition, the issues of upgrading have been eliminated from the end-firm by placing the onus on the ASP to maintain up-to-date services, 24 x 7 technical support, physical and electronic security and in-built support for business continuity and flexible working.

The importance of this marketplace is reflected by its size. As of early 2003, estimates of the United States market range from 1.5 to 4 billion dollars. Clients for ASP services include businesses, government organizations, non-profits, and membership organizations.

**Provider types**

There are several forms of ASP business. These are:

A specialist or functional ASP delivers a single application, such as credit card payment processing or timesheet services;

A vertical market ASP delivers a solution package for a specific customer type, such as a dental practice;

An enterprise ASP delivers broad spectrum solutions;

A local ASP delivers small business services within a limited area.

Some analysts identify a volume ASP as a fifth type. This is basically a specialist ASP that offers a low cost packaged solution via their own website. PayPal was an instance of this type, and their volume was one way to lower the unit cost of each transaction.

In addition to these types, some large multi-line companies (such as IBM), use ASP concepts as a particular business model that supports some specific customers.

**The ASP Model**

The application software resides on the vendor's system and is accessed by users through a web browser using HTML or by special purpose client software provided by the vendor. Custom client software can also interface to these systems through XML APIs. These APIs can also be used where integration with in-house systems is required. ASPs may or may not use multi-tenancy in the deployment of software to clients; some ASPs offer an instance or license to each customer (for example using Virtualization), some deploy in a single instance multi-tenant access mode, now more frequently referred to as "SaaS".

Common features associated with ASPs include:

ASP fully owns and operates the software application(s)

ASP owns, operates and maintains the servers that support the software

ASP makes information available to customers via the Internet or a "thin client"

ASP bills on a "per-use" basis or on a monthly/annual fee

The advantages to this approach include:

Software integration issues are eliminated from the client site

Software costs for the application are spread over a number of clients

Vendors can build more application experience than the in-house staff

Key software systems are kept up to date, available, and managed for performance by experts

Improved reliability, availability, scalability and security of internal IT systems

A provider's service level agreement guarantees a certain level of service

Access to product and technology experts dedicated to available products

Reduction of internal IT costs to a predictable monthly fee.

Redeploying IT staff and tools to focus on strategic technology projects that impact the enterprise's bottom line

Some inherent disadvantages include:

The client must generally accept the application as provided since ASPs can only afford a customized solution for the largest clients

The client may rely on the provider to provide a critical business function, thus limiting their control of that function and instead relying on the provider

Changes in the ASP market may result in changes in the type or level of service available to clients

Integration with the client's non-ASP systems may be problematic

Evaluating an Application Service Provider security when moving to an ASP infrastructure can come at a high cost, as such a firm must assess the level of risk associated with the ASP itself. Failure to properly account for such risk can lead to:

Loss of control of corporate data

Loss of control of corporate image

Insufficient ASP security to counter risks

Exposure of corporate data to other ASP customers

Compromise of corporate data

Some other risks include failure to account for the financial future of the ASP in general, i.e. how stable a company is and if it has the resources to continue business into the foreseeable future. For these reasons Cisco Systems has developed a comprehensive evaluation guideline. This guideline includes evaluating the scope of the ASP's service, the security of the program and the ASP's maturity with regard to security awareness. Finally the guidelines indicate the importance of performing audits on the ASP with respect to:

Port/Network service

Application vulnerability

ASP Personnel

Physical visits to the ASP to assess the formality of the organization will provide invaluable insight into the awareness of the firm.

This description of ASPs appears to be consistent with the description of ASP services in your e-mail and with other ones found on the Internet. The department has said that a number of separately stated fees charged by a ASP provider to its customers for ASP services are not subject to sales tax. These include: recurring monthly charges, set up fees, support fees, training fees, data migration fees, and forms programming fees.

If an ASP sells canned software to a client that can be used independently of the ASP service, the charge is subject to sales tax. Similarly, charges for additional service manuals and software backup that are separately billed to a customer are subject to sales tax. Service manuals and provider software are not subject to sales tax when they are provided to the customer as part of the ASP service package.

Sincerely,

Thomas E. Hatten
Attorney/Policy & Research

**Date Composed: 06/23/2010 Date Modified: 06/23/2010**