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This Week in State Tax (TWIST)

March 17, 2025

Washington State: Certain Content Delivery Network Services Not Subject to Sales Tax

The Washington Board of Tax Appeals (Board) recently issued a determination on whether a taxpayer's content delivery network (CDN) services were digital automated services (DAS) subject to the Washington retail sales tax. The taxpayer provided CDN services which involved replicating and caching customer data across a global network of servers designed to speed the delivery of internet content to the user by ensuring that content was delivered from the server geographically closest to the end user. The taxpayer's customers uploaded their content to the CDN servers, and when end-users requested content from the customer's website, the request was rerouted to the taxpayer's server geographically closest to the end-user for delivery to the user by the user's Internet service provider. Customers were billed on bandwidth utilization or total data transferred. Additionally, the taxpayer offered several supplementary services, including cloud storage, reporting, data analytics, and access to software applications to modify and monetize digital content. On audit, the Department of Revenue determined that the taxpayer's CDN service and its related services were DAS subject to retail sales tax and retailing B&O tax. The assessment was upheld at the administrative level, and the taxpayer appealed to the Board.

Washington imposes a retail sales tax and B&O tax on DAS, defined broadly as services transferred electronically using one or more software applications. The law provides 16 exceptions to taxation for certain types of DAS. Before the Board, the taxpayer argued its CDN services should be exempt as meeting either of two exceptions (1) the internet and internet access as defined in state law, and (2) the "mere storage" of digital products, including providing space for "web hosting" and the back-up of data. With respect to the first exception, the Board found that the terms "internet" and "internet access" incorporate by reference the definitions of the Internet Tax Freedom Act (ITFA), and the "obvious legislative intent" is to comply with the ITFA preemption of state taxation of internet access services. As such, for the CDN services to be exempt, the taxpayer would have to show that they would be excluded from taxation under the ITFA. While the taxpayer's services were a part of the internet, helping speed up the transmission of content over the internet, customers and end-users were required to have internet access to use its services.

With respect to the second exception, the Board found that the taxpayer's CDN service qualified as excluded web hosting service under applicable law. Customers paid the taxpayer to replicate and store their digital content on geographically distributed servers for quicker and more cost-effective delivery to end-users. The use of interconnected servers rather than a single host service did not change the nature of the service. Despite the Department's argument that the taxpayer's services went beyond "mere storage," the Board determined that the application of proprietary algorithms to retrieve, copy, store, route, and purge the customer's digital content were inseparable components of the taxpayer's web hosting service. Therefore, the CDN services were not subject

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to retail sales tax. In addition, the Board found the taxpayer's ancillary services aimed at monetizing digital assets were taxable as they went beyond mere storage and web hosting. Contact *Michele Baisler* for more information on *Limelight Networks, Inc. v. Wash. Dept. Rev*.