

**Letter of Findings Number: 09-0656**  
**Use Tax**  
**For the Periods 2006 and 2007**

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**ISSUES**

**I. Sales and Use Tax—Exemptions.**

**Authority:** IC § 6-2.5-1-24; IC § 6-2.5-1-27; IC § 6-2.5-4-1; IC § 6-2.5-4-6; IC § 6-8.1-5-1; [45 IAC 2.2-3-13](#); [45 IAC 2.2-3-24](#); Sales Tax Information Bulletin No. 8 (May 2002).

Taxpayer protests the assessment of use tax on its office management software license.

**II. Ten-Percent Negligence Penalty.**

**Authority:** IC § 6-8.1-5-1; IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer asks the Department to exercise its discretion to abate the ten-percent negligence penalty on the ground that taxpayer believed it interpreted the applicable statutes correctly.

**STATEMENT OF FACTS**

Taxpayer is a lump sum contractor specializing in electrical construction. Taxpayer holds a retail merchant certificate for sales tax purposes, and is also registered as a withholding agent for the Department of Revenue.

The Department conducted an audit of Taxpayer's business for the 2006 and 2007 tax years (the "Tax Years") and assessed use tax on its purchases of software and associated license agreements. Taxpayer protested the Department's use tax assessment, and a hearing was held. This Letter of Findings results.

**I. Sales and Use Tax—Exemptions.**

**DISCUSSION**

Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed to be accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

During the Tax Years, taxpayer utilized a software program to handle various office management duties commonly performed by a receptionist. Taxpayer incorporated this software in its day-to-day business by purchasing licenses that were accessed through the software vendor's website.

The Department cited [45 IAC 2.2-3-13](#) in its assessment of use tax on taxpayer's purchase of the office management software. That regulation provides that "[t]angible personal property, purchased in Indiana or elsewhere in a retail transaction from a retail merchant, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax[.]" [45 IAC 2.2-3-13](#). And under [45 IAC 2.2-3-24](#), "[a]ll sales of tangible personal property by a retail merchant for delivery in Indiana shall be presumed to be retail transactions for storage, use, or consumption in Indiana." Finally, under Sales Tax Information Bulletin No. 8 (May 2002), the Department deemed the office management programming "pre-written software," and, therefore, subject to use tax.

Taxpayer must interface with vendor's servers to use the software. However, taxpayer asserts that, once the taxpayer's interaction with the vendor's servers closes, the taxpayer loses the downloaded software; the taxpayer must interface with the vendor's servers and reload the software each time the taxpayer wants to use the office management software. Therefore, taxpayer argues that it had not purchased a tangible asset, but merely paid a fee for access to a website.

Taxpayer's protest relies principally on Letter of Findings 07-0173 ("LOF 07-0173"). That Letter of Findings addressed the Department's assessment of sales and use tax on a taxpayer providing access to its proprietary website.

In response to the Department's request, taxpayer provided hard copy screen prints of various displays produced by the software. A copy of an invoice supplied by the taxpayer shows the purchase of six vendor-proprietary "receptionist" lifetime licenses. Taxpayer also provided a copy of a letter sent by the vendor to the taxpayer that states that payment of "a fee" does not confer any rights, assets, or privileges beyond the ability to use the product in exchange for that fee.

The Department first reminds taxpayer that each letter of findings or other document issued as a result of an administrative hearing or procedure relies on facts and circumstances specific to a particular taxpayer. By taxpayer's own admission, its asserted facts and explanations are not identical to those presented in LOF 07-0173.

IC § 6-2.5-4-1 defines a retail transaction as the transfer of tangible personal property for consideration. Taxpayer purchased "receptionist" lifetime licenses. Using an internet browser, Taxpayer goes to the website of the software provider, and by entering its access code, secures use of the office administration programming.

The software vendor sells access to its office administration programming to the general public. Taxpayer purchases a license to gain access allowing transfer of the receptionist software from the vendor's website to the

taxpayer's computer. Taxpayer's ability to use the receptionist software satisfies the "transfer" element of IC § 6-2.5-4-1. Because the software vendor restricts access to those who have paid for a license, taxpayer's payment for access satisfies the "for consideration" element of IC § 6-2.5-4-1.

IC § 6-2.5-1-27 defines "tangible personal property" as personal property that:

(1) can be seen, weighed, measured, felt, or touched; or

(2) is in any other manner perceptible to the senses.

The term includes electricity, water, gas, steam, and **prewritten computer software. (Emphasis added.)**

IC § 6-2.5-1-24 defines prewritten computer software as computer software, including prewritten upgrades, that is not designed and developed by the author or other creator to the specifications of a specific purchaser. Taxpayer does not enjoy a custom version of the software written for it; the vendor makes the software available to all who pay for that access. All three conditional elements of a retail transaction have been satisfied—the transfer of tangible personal property for consideration.

Sales Tax Information Bulletin No. 8 expands on this analysis, stating that custom-written software programs are not subject to sales or use tax if the software is specifically designed for the purchaser. The bulletin also states that "[p]re-written programs... developed by the seller for sale or lease on the general market" are subject to tax; "[p]re-written or canned computer programs are taxable because the intellectual property contained in the canned program is no different than the intellectual property in a videotape or a textbook." *Id.*

Taxpayer has not provided evidence suggesting that the office management software's vendor made any modifications specific to the taxpayer's needs. In fact, statements in the vendor's letter submitted by the taxpayer support the Department's determination that taxpayer did not purchase custom software.

#### FINDING

Taxpayer's protest is respectfully denied.

## II. Ten-Percent Negligence Penalty.

#### DISCUSSION

Taxpayer believes that it is entitled to abatement of the ten-percent negligence penalty because it asserts that it had a reasonable cause for its position that it was exempt from paying sales or use tax when it purchased the "receptionist" lifetime licenses and used the office administration software.

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. IC § 6-8.1-10-2.1(a)(4) requires a ten-percent penalty if the taxpayer "fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment."

IC § 6-8.1-10-2.1(d) states that, "[i]f a person subject to the penalty imposed under this section can show that the failure to... pay the full amount of tax shown on the person's return... or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty."

Departmental regulation [45 IAC 15-11-2](#)(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." *Id.*

IC § 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation [45 IAC 15-11-2](#)(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed...."

Repeating IC § 6-8.1-5-1(c), "[t]he burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment – including the negligence penalty – is presumptively valid.

The Department is prepared to agree that taxpayer had a "reasonable" cause to believe that it was not required to pay sales or use tax when it purchased the "receptionist" lifetime licenses for use of the office administration software.

#### FINDING

Taxpayer's protest regarding the ten-percent negligence penalty is sustained.

*Posted: 03/24/2010 by Legislative Services Agency*  
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