DEPARTMENT OF STATE REVENUE

04-20110118.LOF

Letter of Findings: 04-20110118
Use Tax
For Tax Years 2008 and 2009

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ISSUE

I. Use Tax – Imposition – Computer Maintenance Agreements.

Authority: IC§ 6-2.5-1-1; IC § 6-8.1-5-1; 45 IAC 2.2-4-2; Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Sales Tax Information Bulletin 2 (May 2002) and (December 2006); Letter of Findings 04-20050438 (August 11, 2006).

Taxpayer protests the assessment of use tax on computer maintenance agreements.

STATEMENT OF FACTS

Taxpayer is a medical group that performs various ophthalmic procedures ranging from eye exams, to cataract, laser, and plastic surgery. Taxpayer also sells prescription glasses and contacts.

The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer for the years 2008 and 2009. The auditor and Taxpayer agreed to project additional tax due on general purchases for 2009 based on the rate of error determined by full examination of the 2008 general purchases. Capital assets were excluded from the projection and examined fully for the audit period. Pursuant to the audit, Taxpayer was assessed additional use tax and interest for the years at issue. Taxpayer protested one category of the assessments. A hearing was held and this Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax – Imposition – Computer Maintenance Agreements.

DISCUSSION

The Department assessed Taxpayer additional use tax on purchases of brochures, sunglasses given to patients, diagnostic supplies, medical instruments, subscriptions consumed in the performance of medical services, credit card terminal, and research training publications, DVDs and CDs. In addition Taxpayer purchased medical office software from Compulink, and paid quarterly maintenance charges which included customer support and periodic software updates. Taxpayer was in general agreement with the assessment, but did protest the imposition of use tax on the total amount of computer maintenance agreements which included software update programs. The Taxpayer states that it agrees that the updates to software should be taxable, but not the maintenance agreements.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Taxpayer maintains that its payments were for services rendered and are not subject to sales/use tax. 45 IAC 2.2-4-2 states:

> (a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:
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> (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
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> (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
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> (3) The price charged for tangible personal property is inconsequential (not to exceed 10 [percent]) compared with the service charge; and
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> (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.
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> (b) Services performed or work done in respect to property and performed prior to delivery to be sold by a retail merchant must however, be included in taxable gross receipts of the retail merchant.
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> (c) Persons engaging in repair services are servicemen with respect to the services which they render and retail merchants at retail with respect to repair or replacement parts sold.
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> (d) A serviceman occupationally engaged in rendering professional, personal or other services will be presumed to be a retail merchant selling at retail with respect to any tangible personal property sold by him, whether or not the tangible personal property is sold in the course of rendering such services. If, however, the transaction satisfies the four (4) requirements set forth in 6-2.5-4-1(c)(010), paragraph (1) [subsection (a) of

this section], the gross retail tax shall not apply to such transaction.

Notably, only when the four requirements mentioned above are fulfilled, is a taxpayer entitled to the exemption pursuant to 45 IAC 2.2-4-2(a).

In Letter of Findings 04-20050438 (August 11, 2006), 20061101 Ind. Reg. 045060474NRA, the Department addressed the question of whether "Software Maintenance Agreements" were subject to sales tax. The Department found that these agreements were subject to sales tax on a "prospective basis" as follows:

> There is no regulation that sets out the department's position regarding the application of sales and use tax to optional warranties. The department first issued Sales Tax Information Bulletin [] 2 concerning Optional Warranties... on May 2, 1983. In that Information Bulletin, the department explained that if there was a possibility that no tangible personal property would be transferred with the warranty, then there was no certainty that there would be a retail sale and the sales and related use tax did not apply. This position was restated in the revised Sales Tax Division Information Bulletins issued in August 1991, November 2000, and May 2002. Each of the revisions restated the general rule. In the May 2002 revision, it was stated "[o]ptional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are not subject to sales tax." Each of the revisions also gave a specific example concerning computer software situations. The examples stated that sales and use tax would apply to the sale of an optional warranty or maintenance agreement in the software situation only if there was a guarantee of the transfer of tangible personal property (updates) pursuant to the agreement.
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> Computer technology and use has evolved since the issuance of the first Sales Tax Information Bulletin [] 2 on May 2, 1983. Almost all software optional warranties and software maintenance agreements sold today include the automatic provision of updates-sometimes on a day-by-day or week-by-week basis. Purchasers of these agreements have a reasonable expectation that they will receive the updates whether or not the actual contract couches the provision of updates as "optional." The substance of the agreements is that tangible personal property in the form of software updates will be provided no matter what the language of the contract says. The department determines tax consequences by construing the substance of the agreement over the form. Wholesalers, Inc. v. Indiana Department of State Revenue, 597 N.E.2d 1339 (Ind. Tax 1992). In the case of software maintenance agreements or optional warranties, it is clear that the parties presume that tangible personal property in the form of updates will be transferred. Therefore, the department will construe software maintenance agreements and optional agreements as presumed to be subject to the sales and use tax. A taxpayer could rebut this presumption by demonstrating that no updates were actually received pursuant to a particular maintenance agreement or optional warranty. (Emphasis added).
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> Taxpayer's letter states that their vendor does not itemize its invoices. IC § 6-2.5-1-1(a) provides:
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> Except as provided in subsection (b), "unitary transaction" includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated.

These agreements (by Taxpayer's own words) call for the provision of both services and tangible personal property for a single price and are therefore unitary transactions.

The Department's position on this has been consistent; unless a taxpayer can demonstrate that it received no software updates during the term of the maintenance agreement, the Department will presume that the maintenance agreements are subject to sales/use tax.

Taxpayer was not able to provide a copy of the software maintenance agreement to the Hearing Officer, nor demonstrate that it did not receive upgrades, and, finally, Taxpayer's vendor did not itemize its invoices. Taxpayer has not rebutted the presumption "that tangible personal property in the form of updates will be transferred," therefore, the software maintenance agreements are subject to use tax.

Going forward, and for Taxpayer's future reference, the Department notes that the most recent version of Sales Tax Information Bulletin 2 (December 2006), 20100804 Ind. Reg. 045100497NRA, (effective August 4, 2010) states in relevant part:

> In the case of software maintenance agreements or optional warranties, the presumption is that tangible personal property in the form of updates will be transferred. Software maintenance agreements and optional warranties are presumed to be subject to sales and use tax. This presumption can be rebutted if the taxpayer can demonstrate that no updates were actually received. **Examples:**
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> 4. A computer software company sells a taxable software package to a customer. The customer also purchases an optional maintenance agreement from the company. The maintenance agreement entitles the customer to a maximum of 20 hours of programmer help to deal with any problems the customer might have in using the software package. The maintenance agreement also entitles the customer to periodic software updates. The software maintenance agreement is subject to sales tax.

FINDING

Taxpayer's protest of the imposition of use tax on software maintenance agreements is respectfully denied.

Posted: 01/25/2012 by Legislative Services Agency

An html version of this document.