

Letter of Findings: 04-20110478
Use Tax
For 2008, 2009, and 2010

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ISSUES

I. Use Tax – Software.

Authority: IC § 6-2.5-1-24; IC § 6-2.5-1-27; IC § 6-8.1-5-1.

Taxpayer argues that it was not subject to use tax on items listed as "data processing equipment."

II. Use Tax – Prewritten Computer Software.

Authority: IC § 6-2.5-1-27; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-8.1-5-1.

Taxpayer asserts that it was not subject to use tax on prewritten computer software purchased from a third-party vendor.

III. Use Tax – Payment of Sales Tax.

Authority: IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-8.1-5-1; Sales Tax Information Bulletin 2 (December 2006).

Taxpayer asserts that it was not subject to use tax on certain items because it had either paid sales tax or the charges represented nontaxable transactions.

STATEMENT OF FACTS

Taxpayer is a corporation doing business in Indiana. The Indiana Department of Revenue ("Department") audited Taxpayer and determined that it owed use tax on several items. Taxpayer protested the imposition of use tax on two separate charges for computer software, an invoice on which Taxpayer claims to have paid sales tax, and an invoice for installation services related to a printer. An administrative hearing was conducted during which Taxpayer explained the basis for its protest. This Letter of Findings results.

I. Use Tax – Software.

DISCUSSION

Taxpayer protests the imposition of Indiana use tax on one invoice. In the Department's audit report, the Department listed the item as "data processing equipment." Taxpayer protests that the invoice represents either services related to software or custom-written computer software.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

Under IC § 6-2.5-1-27, tangible personal property is defined to include prewritten computer software. IC § 6-2.5-1-24 defines "prewritten computer software" as:

Subject to the following provisions, "prewritten computer software" means computer software, including prewritten upgrades, that is not designed and developed by the author or other creator to the specifications of a specific purchaser:

- (1) The combining of two (2) or more prewritten computer software programs or prewritten parts of the programs does not cause the combination to be other than prewritten computer software.
- (2) Prewritten computer software includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than the purchaser.
- (3) If a person modifies or enhances computer software of which the person is not the author or creator, the person is considered to be the author or creator only of the person's modifications or enhancements.
- (4) Prewritten computer software or a prewritten part of the software that is modified or enhanced to any degree, where the modification or enhancement is designed and developed to the specifications of a specific purchaser, remains prewritten computer software.

However, where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for such a modification or enhancement, the modification or enhancement is not prewritten computer software.

Thus, prewritten computer software is considered tangible personal property subject to sales tax. However, if software is custom written (or modified) for a customer, then the software (or portion thereof) customized for that customer is not considered "prewritten computer software" and the services related to customization are not subject to sales and use tax if the customization charges are separately listed.

Taxpayer provided a copy of the invoices related to the transaction between Taxpayer and the vendor. The invoices indicate that Taxpayer purchased customization of software and services related to the customization of the software. Thus, Taxpayer has established that the purchase was not the purchase of tangible personal

property—either "equipment" or prewritten computer software—and thus Taxpayer's protest is sustained on this issue.

FINDING

Taxpayer's protest is sustained.

II. Use Tax – Prewritten Computer Software.

DISCUSSION

Taxpayer protests the imposition of use tax on computer software purchased from a third-party vendor. The auditor assessed Indiana use tax on the full purchase price of the software. Taxpayer maintains that only a portion of the software is used in Indiana. The issues are whether the software is used in Indiana and the amount of the software used in Indiana.

As a threshold issue, it is Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

Taxpayer described its software purchases as a purchase of three different types of licenses. According to Taxpayer, Type One is a license for data storage software. Type Two is a license for training software. Type Three is a license for information retrieval and organization software. According to Taxpayer, all the software is located on servers outside Indiana. Further, according to Taxpayer, the Type One and Type Two licenses are not used by Taxpayer but rather are used by corporate affiliates of Taxpayer. Of the Type Three licenses, Taxpayer purchased 100 licenses according to the invoice submitted by Taxpayer. Taxpayer further provided a breakdown of the locations at which the Type Three software was used as of approximately September 1, 2011.

According to IC § 6-2.5-3-2(a):

An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

In addition, IC § 6-2.5-3-1 defines "use" as "the exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-1-27 defines "tangible personal property" to include prewritten computer software.

In this case, Taxpayer has provided sufficient information to conclude that the Type One licenses and Type Two licenses referenced by Taxpayer were not used in Indiana. Therefore, Taxpayer is sustained with regard to items one through six listed on the third party vendor's invoice.

With regard to item seven, Taxpayer asserts that only seven of the 100 licenses were charged to Taxpayer. Taxpayer has provided documentation related to the software. In particular, Taxpayer has provided internal documentation demonstrating that its parent charged seven licenses to Taxpayer. Based on this information, Taxpayer has provided sufficient documentation to substantiate its argument. Thus, Taxpayer is subject to use tax on the cost of seven Type Three licenses, or \$8,133.30.

FINDING

Taxpayer's protest is sustained on the software licenses purchased with the exception of licenses worth \$8,133.30.

III. Use Tax – Payment of Sales Tax.

DISCUSSION

Taxpayer protests the imposition of use tax on several invoices. As a threshold issue, it is Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

A. Vendor One Invoices.

Taxpayer protests the imposition of use tax related to several invoices from a company ("Vendor One"). The Department's audit determined that Taxpayer had not remitted sales tax on portions of the invoices and thus assessed use tax on the untaxed portions. While IC § 6-2.5-3-2 imposes a use tax on tangible personal property used in Indiana, IC § 6-2.5-3-4 provides an exemption from use tax when Indiana sales tax had been imposed on the property.

During the hearing, Taxpayer explained that, whenever it purchased items, Taxpayer produced a "Purchase Order" which served to provide an estimate of the amount to be spent. These "Purchase Orders" were not the invoice for the actual transaction. At hearing, Taxpayer provided the actual invoices for the taxable transactions.

The invoices provided by Taxpayer substantiate that sales tax was generally paid on the listed items. However, sales tax was not charged on several items.

The first item is "SMARTnet 8X5XNBD." Taxpayer has stated that this "is a charge for maintenance on the items being purchased." However, Taxpayer has not established that these items were not subject to sales and use tax pursuant to Sales Tax Information Bulletin 2 (December 2006), 20100804 Ind. Reg. 045100497NRA.

The second item is "On Site 24x7x4 Cisco 5508 Series Wireless." With regard to this item, this item appears to be a warranty or maintenance agreement provided in conjunction with tangible personal property. Taxpayer

has not established that this item was not subject to sales and use tax pursuant to Sales Tax Information Bulletin 2 (December 2006).

Notwithstanding Taxpayer's protest of any other invoices from Vendor One, Taxpayer protests the tax imposed on items listed in one particular invoice ("Invoice 32"). Taxpayer asserts that this invoice was for items delivered to a location outside Indiana. According to the invoice, the items listed on the invoice were shipped to a location in another state. Based on the ship-to location on this particular invoice and the ship-to location listed on other invoices, Taxpayer has provided sufficient information to conclude that the items listed on this invoice were not used in Indiana. Thus, none of the listed items on this invoice was subject to Indiana sales and use tax.

B. AIDEA Invoice.

Taxpayer also protests the imposition of use tax on an invoice from AIDEA Inc. According to the Department's audit, Taxpayer incurred \$450 in charges for blades installed on a printer. Taxpayer asserts that the charges represent labor costs for installation of the blades. The invoice lists two charges. The first charge lists "REPAIR" of the blades, but the word "REPAIR" is crossed out and the word "Installation" is handwritten on the invoice. The second charge is for the time the vendor's agent drove to Taxpayer's location.

After review of the AIDEA invoice and information related to the purchase of the printer, Taxpayer has provided sufficient information to conclude that the invoice was for charges related to services rather than for tangible personal property. Thus, Taxpayer's protest is sustained on this invoice.

FINDING

Taxpayer's protest is sustained on the listed invoices except as stated above.

CONCLUSION

1. Taxpayer's protest is sustained on the invoices that constituted "computer equipment" in Issue I.
2. Taxpayer's protest is sustained with regard to the software assessed in Issue II except for \$8,133.30 in charges for software.
3. Taxpayer's protest of tax assessed on Vendor One invoices is sustained except with regard to certain specific charges set forth in Part III above.
4. Taxpayer's protest of Vendor One Invoice 32 is sustained.
5. Taxpayer's protest of the assessment on an invoice from AIDEA is sustained.

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