

DEPARTMENT OF STATE REVENUE

Revenue Ruling # 2014-01ST
October 30, 2015

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ISSUES

Sales and Use Tax - Internet Based Product

A taxpayer ("Company") is seeking an opinion as to whether Company's product ("Product") is not subject to Indiana sales and use tax when sold to customers located in Indiana. Specifically, Company seeks a ruling regarding the following issues:

1. Is Company's sale of the Product Membership to Indiana customers subject to sales and use tax?
2. Is Company's provision of the free, one-month trial period of the Product Membership to Indiana customers subject to sales and use tax?

Authority: [IC 6-2.5-1-24](#); [IC 6-2.5-1-26.5](#); [IC 6-2.5-1-27](#); [IC 6-2.5-1-27.5](#); [IC 6-2.5-1-28.5](#); [IC 6-2.5-2-1](#); [IC 6-2.5-2-2](#); [IC 6-2.5-4-1](#); [IC 6-2.5-4-6](#); [IC 6-2.5-4-16.4](#); [45 IAC 2.2-1-1](#); [45 IAC 2.2-4-2](#); Streamlined Sales and Use Tax Agreement (Oct. 8, 2014)

STATEMENT OF FACTS

Company is a Washington state corporation that sells a variety of products over the internet. Company provides the following facts regarding its request for a revenue ruling:

Company offers a membership program known as [Product]. The general public may sign up for a free trial or paid [Product] Membership and receive certain membership benefits associated with shopping on [Company's Website] during the membership period. The free trial period is one month and the paid membership period is one year. Participants in the membership program are referred to as "[Product] Members." [Product] Members agree to the [Product] Terms & Conditions . . .

The membership benefits provided to [Product] Members are described below:

- Shipping - [Product] Members are entitled to receive free two-day shipping and other discounted shipping benefits on eligible purchases made on the [Company Website].¹ Products eligible for these shipping benefits are designated as such on the Website's product pages. Also, certain products sold by third-party merchants participating in [Product] through the "Fulfillment by [Company]" program are eligible for [Product]'s shipping benefits.
- [Streaming Video Benefit] - [Product] Members may view movies and television shows designated as [Streaming Video Benefit] an unlimited number of times at no additional cost during the course of their [Product] Membership. The [Streaming Video Benefit] can be viewed on the [Product] Member's television, computer, Xbox gaming system, [Electronic Tablet], or other compatible device. [Product] Members can stream the [Streaming Video Benefit] and [Product] Members with a [Smartphone], [Electronic Tablets] can download the [Streaming Video Benefit] if their phone or tablet is registered to the same [Company] account as their [Product] Membership. The downloaded [Streaming Video Benefit] may be viewed without an Internet connection.
- [E-books Loaned for E-book Readers Benefit] - The [E-books Loaned for E-book Readers Benefit] allows [Product] Members who own [E-Book Readers] to choose from thousands of electronic books ("e-books") to borrow for free, as frequently as a book a month, with no due dates. [Product] Members can only borrow one e-book at a time. [Product] Members must own a [E-Book Reader] that is registered to the same [Company] account as the [Product] Membership in order to access this benefit.

- [Free E-Book Benefit] - The [Free E-Book Benefit] feature allows [Product] Members who own [E-Book Reader] to select and receive one free e-book per month from four e-books selected by [Company] editors. The selected e-book becomes a permanent part of the [Product] Member's [E-Book Reader] library. [Product] Members must own a [E-Book Reader] that is registered to the same [Company] account as the [Product] Membership in order to access this benefit.
- [Bulk Item Benefit] - The [Bulk Item Benefit] allows [Product] Members to have up to 45 pounds of heavy/bulky items delivered for a flat shipping fee of \$5.99. The heavy/bulky items in [Bulk Item Benefit] are only available for purchase by [Product] Members.
- Exclusive Access to [Essential Items] - [Essential Items] is a line of premium everyday essential products such as baby wipes. [Essential Items] products are only available for purchase by [Product] Members.
- [Discount Pricing] - [Discount Pricing] provides discounts to [Product] Members on sales of certain tangible personal property. For example, [Product] Members can purchase certain televisions and software at a discount. The products offered to [Product] Members at a discount continues to expand.
- [Advanced Purchase Benefit] - [Product] Members receive 30 minute early access to select [Deals] on the [Company Website] and sales events on [Related Website]. The deals and sales events are designated as such on the product detail page or on the website.
- [Music Benefit] - [Music Benefit] provides [Product] Members with unlimited, ad-free access to more than a million songs and albums. [Music Benefit] may be played on the [Product] Member's computer, [Electronic Tablet], or other compatible device. [Music Benefit] may be streamed or downloaded for listening without an Internet connection.
- [Photograph Benefit] - [Product] Members receive unlimited storage for photos in the [Company Cloud Drive] and 5GB of storage for videos and files. [Product] Members must have a [Company Cloud Drive] account registered to the same [Company] account as their [Product] Membership. As long as the [Product] Membership is active, photos uploaded to the [Product] Member's [Company Cloud Drive] will not count against the [Product] Member's 5GB's of fixed storage capacity in the [Company Cloud Drive] for files and videos.
- [Electronic Button] - Currently, [Product] Members can request an invitation to receive up to 3 [Electronic Buttons]. [Electronic Buttons] allow customers to simply press the button when the customer needs to reorder a product. Upon pressing the button, an order is placed through the customer's [Company] account for the product. Each button works for a single product. For example, a customer could obtain a button for Tide laundry detergent and, upon running out of laundry detergent, the customer can press the button and an order will automatically be placed for the product and shipped to the customer. While [Electronic Buttons] are currently only available to select [Product] Members that receive an invitation, they may be available to all [Company Account Holders] in the future.

While Company does not directly provide the membership benefits to [Product] Members, it is contractually obligated to ensure the benefits are provided. To meet its contractual obligations, Company pays its affiliates to provide the underlying service related to each benefit. For example, an affiliate of Company provides the shipping service and another affiliate provides e-books.

DISCUSSION

Based on the foregoing facts, Company requests a ruling as to whether its Product Membership is exempt from sales and use tax, either as a full-year subscription or as a one-month free trial.

Pursuant to [IC 6-2.5-2-1\(a\)](#) and [IC 6-2.5-2-2\(a\)](#), sales tax is imposed on retail transactions made in Indiana. A retail transaction is defined in [IC 6-2.5-4-1\(b\)](#) as the transfer, in the ordinary course of business, of tangible personal property for consideration.

[IC 6-2.5-4-1](#) provides in pertinent part:

- (a) A person is a retail merchant making a retail transaction when the person engages in selling at retail.
- (b) A person is engaged in selling at retail when, in the ordinary course of the person's regularly conducted trade or business, the person:

- (1) acquires tangible personal property for the purpose of resale; and
- (2) transfers that property to another person for consideration.
- (c) For purposes of determining what constitutes selling at retail, it does not matter whether:
 - (1) the property is transferred in the same form as when it was acquired;
 - (2) the property is transferred alone or in conjunction with other property or services; or
 - (3) the property is transferred conditionally or otherwise.

"Tangible personal property" is defined in [IC 6-2.5-1-27](#) 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.

Except for certain enumerated services, sales of services generally are not retail transactions and are not subject to sales or use tax. [45 IAC 2.2-4-2](#) clarifies the taxability of services as follows:

- (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:
 - (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
 - (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
 - (3) The price charged for tangible personal property is inconsequential (not to exceed 10%) compared with the service charge; and
 - (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.
- (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.
- (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.
- (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 [subsection (a)], the gross retail tax shall not apply to such transaction.

[IC 6-2.5-1-1](#) states in pertinent part:

- (a) 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.
 - (b) "Unitary transaction" as it applies to the furnishing of public utility commodities or services means the public utility commodities and services which are invoiced in a single bill or statement for payment by the consumer.
- ...

A unitary transaction is clarified in [45 IAC 2.2-1-1\(a\)](#) as follows:

Unitary Transaction. For purposes of the state gross retail tax and use tax, such taxes shall apply and be computed in respect to each retail unitary transaction. A unitary transaction shall include all items of property and/or services for which a total combined charge or selling price is computed for payment irrespective of the fact that services which would not otherwise be taxable are included in the charge or selling price.

Sales of specified digital products are also included in the definition of retail transactions. [IC 6-2.5-4-16.4\(b\)](#) provides that a person engages in making a retail transaction when the person (1) electronically transfers specified digital products to an end user; and (2) grants to the end user the right of permanent use of the specified digital products that is not conditioned upon continued payment by the purchaser. "Specified digital products," as currently defined by [IC 6-2.5-1-26.5](#), include only digital audio works (e.g., songs, spoken word recordings,

ringtones), digital audiovisual works (e.g., movies), and digital books. Products "transferred electronically" are defined at [IC 6-2.5-1-28.5](#) to mean products that are "obtained by a purchaser by means other than tangible storage media."

Pursuant to Section 333 ("Use of Specified Digital Products," effective Jan. 1, 2010) of the Streamlined Sales and Use Tax Agreement ("SSUTA," effective Oct. 8, 2014), of which Indiana is a signatory, "A member state shall not include any product transferred electronically in its definition of 'tangible personal property.'" Pursuant to the same section of the SSUTA, "ancillary services," "computer software," and "telecommunication services" are excluded from the term "products transferred electronically."

In order to stay in conformity with the SSUTA, Indiana may not impose sales tax on a product transferred electronically by basing the product's taxability on inclusion of the product in the definition of tangible personal property. It is important to note that "ancillary services," "computer software," and "telecommunication services" are not restricted by the phrase "product transferred electronically." However, [IC 6-2.5-1-27.5\(c\)\(8\)](#) explicitly excludes ancillary services from the definition of telecommunication services, which are taxable under [IC 6-2.5-4-6](#). Accordingly, ancillary services are not subject to sales tax in Indiana.

Based on the foregoing, Indiana may impose sales tax on products transferred electronically only if the products meet the definition of specified digital products, pre-written computer software, or telecommunication services.

"Prewritten computer software" is defined in [IC 6-2.5-1-24](#) as follows:

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.

"Telecommunication services" is defined in [IC 6-2.5-1-27.5](#) as follows:

- (a) "Telecommunication services" means electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points.
- (b) The term includes a transmission, conveyance, or routing in which computer processing applications are used to act on the form, code, or protocol of the content for purposes of transmission, conveyance, or routing regardless of whether the service:
 - (1) is referred to as voice over Internet protocol services; or
 - (2) is classified by the Federal Communications Commission as enhanced or value added.
- (c) The term does not include the following:
 - (1) Data processing and information services that allow data to be generated, acquired, stored, processed, or retrieved and delivered by an electronic transmission to a purchaser whose primary purpose for the underlying transaction is the processed data or information.
 - (2) Installation or maintenance of wiring or equipment on a customer's premises.
 - (3) Tangible personal property.
 - (4) Advertising, including but not limited to directory advertising.
 - (5) Billing and collection services provided to third parties.
 - (6) Internet access service.
 - (7) Radio and television audio and video programming services, regardless of the medium, including the furnishing of transmission, conveyance, and routing of the services by the programming service provider. Radio and television audio and video programming services include cable service as defined in 47 U.S.C. 522(6) and audio and video programming services delivered by commercial mobile radio service providers, as defined in 47 CFR 20.3.
 - (8) Ancillary services.

- (9) Digital products delivered electronically, including the following:
- (A) Software.
 - (B) Music.
 - (C) Video.
 - (D) Reading materials.
 - (E) Ring tones.

A one-year Product Membership provides Product Members access to many different benefits or features. Product Members pay a single annual fee, which allows them access to every feature or benefit that Product offers. In other words, there are no separately stated charges for access to each feature or benefit. In order to determine whether the fee is subject to sales or use tax, the main question is whether the transaction for a Product Membership includes a transfer of tangible personal property, prewritten computer software, specified digital products, or taxable services such as telecommunication services.

With regards to prewritten computer software or other tangible personal property, Company does transfer software as part of the Product Membership. For instance, Product Members can separately download an application (or "app") on their smartphone, tablet, or similar device in order to access some of the features of Product, such as Streaming Video Benefit, for free. However, because Company makes available for free the software their Product Members use with the Product Membership, there would be no sale, and thus sales tax would not apply. In fact, people can download the apps without having a Product Membership.

Company does transfer specified digital products as a part of Product Membership. As mentioned above, "specified digital products" includes digital audio works (e.g., songs, spoken word recordings, ringtones), digital audiovisual works (e.g., movies), and digital books. [IC 6-2.5-1-26.5](#). [IC 6-2.5-4-16.4](#)(b) provides that a person engages in making a retail transaction when the person (1) electronically transfers specified digital products to an end user; and (2) grants to the end user the right of permanent use of the specified digital products that is not conditioned upon continued payment by the purchaser. While Product Members do not have the right of permanent use of the videos streamed in the Streaming Video Benefit, music streamed or downloaded through Music Benefit, or digital books downloaded through the E-books Loaned for E-book Readers Benefit, Product Members do have the right of permanent use of digital books downloaded through Free E-Book Benefit.

As stated above, [45 IAC 2.2-4-2](#)(a) clarifies the taxability of services when tangible personal property is also transmitted:

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:

- (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
- (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
- (3) The price charged for tangible personal property is inconsequential (not to exceed 10%) compared with the service charge; and
- (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

Company would fail the first test, as Company is primarily a seller of tangible personal property. Company would also fail the second test, as it is not a necessary incident to the service, but a separate benefit to the customer. Company is also not likely paying gross retail tax or use tax on the digital books either. By selling services and transmitting digital books through Free E-Book Benefit, this would be considered a "unitary transaction." [IC 6-2.5-1-1](#).

Company's Product Membership services appear to not meet the definition of a "telecommunication service," as they would be excluded under [IC 6-2.5-1-27.5](#)(c)(1) and (9). On that note, while shipping is a service that is not subject to sales or use tax, charges for delivery are subject to sales or use tax if the charges are not separately stated postage charges. Shipping is free for Product Members, and as such there would be no delivery charges when a Product Member orders an item for delivery. However, it could be argued that Product Members are paying for delivery in the form of their membership fees.

With all this being said, while Customers have access to all of these features, a customer will not necessarily utilize each feature. As with optional warranty contracts, which are not subject to sales tax because there is no certainty whether any tangible personal property will be provided, there is no certainty that all of the features

offered under a Product Membership will be utilized by each Product Member that pays an annual membership fee, and thus there is no certainty whether tangible personal property or specified digital products will be transferred either. A Product Member could choose only nontaxable features, such as the Streaming Video Benefit, once the membership period begins.

Essentially, a Product Membership entitles a Product Member access to many different features and benefits after the fee is paid. Based on the information provided, the annual fee for a "Product Membership" is not subject to sales or use tax, as it would not meet the definition of a retail transaction because no property is transferred for consideration upon the purchase of the membership fee. It does not with certainty constitute or include sales of tangible personal property, specified digital products, prewritten computer software, or telecommunication services. By that same logic, a free monthly trial would also not be subject to sales or use tax. However, any additional amounts charged by Company for specified digital products, tangible personal property, delivery charges, or taxable services would still be subject to sales or use tax.

RULING

The annual fee for Company's "Product Membership" does not meet the definition of a retail sale pursuant to [IC 6-2.5-4-1](#), and therefore the fee or free monthly trial is not subject to Indiana sales and use tax.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances as stated herein are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling a change in statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

¹ Shipping benefits also apply to certain products sold on third-party websites that offer [Product] shipping benefits.

Posted: 11/25/2015 by Legislative Services Agency
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