

**Letter of Findings: 04-20160317**  
**Sales and Use Tax**  
**For Tax Years 2013 & 2014**

**NOTICE:** IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

**HOLDING**

Information Technology Company does not owe additional gross retail tax on online backup software because software is provided incident to the provision of a service.

**ISSUE**

**I. Gross Retail Tax - Online Software Services.**

**Authority:** IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-4-1; IC § 6-8.1-5-1; IC § 6-2.5-1-24; IC § 6-2.5-1-27; Dep't of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Ind. Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); [45 IAC 2.2-4-2](#).

Taxpayer protests the Department's imposition of gross retail tax on online backup software.

**STATEMENT OF FACTS**

Taxpayer is an Indiana company in the business of computer information technology support for computer hardware/software, network planning, installation, maintenance, and backup services. The Indiana Department of Revenue ("Department") conducted a sales/use tax audit of Taxpayer for the 2013 and 2014 tax years and issued proposed assessments for additional amounts of sales tax and interest. The Department determined that Taxpayer failed to collect and remit retail sales tax on certain transactions; specifically at issue, the Department concluded that Taxpayer owed gross retail sales tax on online backup software subscription services. Taxpayer protested the audit's assessment of additional retail sales tax on these service charges. An administrative hearing was held and this Letter of Findings results. Additional facts will be provided as necessary.

**I. Gross Retail Tax - Online Software Services.**

**DISCUSSION**

Taxpayer disputes the imposition of retail sales tax on online backup services. Taxpayer's in-state and out-of-state servers run software from its servers ("server-side software") that controls software installed on clients' computer systems ("client-side software") in performing data backup operations. The client-side software communicates with software stored on Taxpayer's servers in order to complete the backup process and does not function independently of the server-side software. Taxpayer performs the backup services as a "value added" service as part of its information technology services offered to clients, and the backup services are performed by Taxpayer automatically or at the request of its clients. Per the terms of the service agreement, clients are required to delete the client-side software upon termination of the agreement with Taxpayer.

As an initial matter, the Department notes that all tax assessments are prima facie evidence that the Department's claim for the tax is valid, and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Sq. Amoco, Inc. v. Ind. Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Ind. Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012). Thus, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. In reviewing a taxpayer's argument, the Indiana Supreme Court has held that when it examines a statute that an agency is "charged with enforcing . . . we defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party." Dep't of State Revenue v. Caterpillar, Inc., 15

Pursuant to IC § 6-2.5-2-1, a sales tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. IC § 6-2.5-1-2 defines a retail transaction as "a transaction of a retail merchant that constitutes selling at retail as described in IC § 6-2.5-4-1 . . . or that is described in any other section of IC § 6-2.5-4." 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.

The audit report found that the installation of the client-side software constituted a transfer of tangible personal property, and was thus subject to sales tax. The audit report concluded that Taxpayer was transferring tangible personal property because Taxpayer's website states that the online backup subscription includes "state of the art software and robust infrastructure." Taxpayer argues that it is providing a service to its clients, and the transaction, therefore, does not involve the transfer of tangible personal property.

"Tangible personal property" is defined 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**." IC § 6-2.5-1-27 (**emphasis added**). Pre-written computer software is defined in IC § 6-2.5-1-24 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."

Except for certain enumerated services, sales of services generally are not retail transactions and are not subject to sales tax. [45 IAC 2.2-4-2\(a\)](#) clarifies the taxability of services when tangible personal property is also transmitted:

- (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.**

(Emphasis added).

The online backup software, when transmitted to Taxpayer's clients, constitutes pre-written computer software and therefore meets the definition of tangible personal property under IC § 6-2.5-1-27. However, this property is transmitted to Taxpayer's clients incident to the service provided, which is data backup. Taxpayer satisfies all of the requirements of [45 IAC 2.2-4-2\(a\)](#) for finding that the online backup services provided by Taxpayer are non-taxable. First, Taxpayer is primarily in the business of providing information technology services to its clients. Second, the online backup software is for the purpose of enabling Taxpayer to provide the backup services, and clients cannot use the client-side software independently of the actions initiated by Taxpayer from the server-side software. In addition, Taxpayer retains ownership of the software, and clients are required to delete the client-side software upon termination of the service agreement. Third, clients do not incur an additional charge for the installation of the client-side software, but instead pay a flat monthly service charge based upon the amount of data to be transferred. Finally, the software at issue was custom designed for Taxpayer in 2001, thus the initial acquisition of the software was not a taxable transaction because it did not meet the definition of "prewritten computer software" under IC § 6-2.5-1-24—and was therefore not tangible personal property—at the time it was acquired. Taxpayer has shown that its clients do not acquire the online backup software for their own independent use, and the software is solely for the purpose of allowing Taxpayer to perform the services contracted for with its clients.

Taxpayer has met its burden under IC § 6-8.1-5-1(c) of demonstrating that the transactions at issue are not subject to sales tax and that the assessment is incorrect. Therefore, Taxpayer's protest regarding the assessment of additional sales tax on the online backup software is sustained.

### FINDING

Taxpayer's protest is sustained.

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