DEPARTMENT OF STATE REVENUE

Revenue Ruling #2016-02ST
September 30, 2016

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the department's official position concerning a specific issue.

ISSUES

Sales and Use Tax - Coupon Clearing Services and Related Software

A company ("Taxpayer") is seeking an opinion as to whether Taxpayer's products are services that are not subject to the Indiana sales and use tax when sold to clients located in Indiana. Specifically, Taxpayer seeks a ruling regarding the following:

1. Are Taxpayer's base coupon clearing service fees subject to tax as an enumerated service?
2. Are Taxpayer's charges for access to remotely hosted software taxable?
3. If the Department elects to clarify the treatment of access charges for hosted software as part of this ruling, how does the Department's clarification apply to Taxpayer's charges?
4. Assuming Taxpayer's software access is taxable, does the software access charge cause the base service fee to become taxable when Taxpayer bundles the software access charge within its base service fee?
5. Assuming Taxpayer's software access is taxable, does the unitary transaction rule cause the base service fee to become taxable when Taxpayer separately states the software access charge?

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; Sales Tax Information Bulletin #8 (November 2011); Commissioner's Directive #41 (December 2014); Streamlined Sales and Use Tax Agreement (May 16, 2016)

STATEMENT OF FACTS

Taxpayer is a Delaware C-corporation that is headquartered in Illinois. It has no facilities, employees, or inventory in Indiana, although occasionally Taxpayer's employees may enter Indiana to visit clients to carry on business in Indiana. Taxpayer provides coupon clearing services for discount coupons redeemed at retail stores located in the state of Indiana by consumers who reside in Indiana.

Taxpayer provides the following facts regarding its request for a revenue ruling:

> Taxpayer's client is the retailer who redeems the coupons or the advertiser whose product or service is subject to the discount offered via the coupon. An advertiser will separately contract with a third party to place the advertiser's coupons in newspapers, direct mail, and other tangible advertising media distributed in the state of Indiana as well as on internet websites, mobile applications, and other electronic distribution platforms accessible via computers and mobile devices located in the state of Indiana. Taxpayer does not design, print, or distribute coupons. Instead, Taxpayer's clients engage Taxpayer to manage the client's coupon verification and payment function, including the monetary transactions connected with the redemption of coupons submitted by retailers.
>
> The practice of redeeming coupons at a retailer's point of sale requires the retailer to provide a discount to its shopping customer against the selling price of a product and to perform various administrative functions as required to obtain reimbursement of that discount from the advertiser. Per industry practice, an advertiser is required to reimburse the retailer for the discount and to pay the retailer one or more fees for the administrative burden imposed on the retailer. Almost all retailers and advertisers use a coupon clearinghouse as a "middle-man" to manage the data flowing between the retailer and the advertiser and to facilitate the payment of the monies owed by the advertiser to the retailer. Taxpayer acts as a coupon clearinghouse that facilitates the flow of data and funds for its clients. Each of Taxpayer's clients must enter into a written coupon clearing services agreement that explicitly establishes a formal agency relationship between the taxpayer and the client. This agency relationship is disclosed to all retailers and advertisers with whom Taxpayer interacts on behalf of the client. Further, standard industry practice ensures that all parties

interacting with Taxpayer recognize that Taxpayer is a formal agent on behalf of its client.

Taxpayer does not begin providing its coupon clearing services until it receives a batch of coupons from a retailer. Taxpayer's services typically consist of:

1. Receipt and separation of coupons
2. Manual scanning of coupons into Taxpayer's production system
3. Manual review of coupons for fraud prevention
4. Automated analysis of coupons by Taxpayer's system to support fraud prevention
5. Automated application of advertiser payment policies (regarding coupon expiration dates and redemption exceptions)
6. Destruction of the physical coupons after processing
7. Transmission of coupon data to Taxpayer's servers for storage
8. Tabulation of payments owed by advertisers to retailers, transmission of the required funds to retailers, and management of an advertiser's on-going funding requirements

In performing its services, Taxpayer populates databases within its production systems with the offer and coupon data obtained from scanning and validating the coupons submitted by the retailers. All scanning activities occur outside Indiana; the servers on which the data is stored are located outside the state of Indiana; and the maintenance of the servers occurs outside the state of Indiana. Taxpayer charges each of its clients (i.e. both advertisers and retailers) a bundled base service fee that covers all or a portion of the services listed above. In addition, Taxpayer may impose one or more separately stated charges for a variety of other services that may be required by a particular client.

As part of its service offering, Taxpayer provides each client with access to Taxpayer-created software that enables the client to run various reports to view the coupon and payment data applicable to the client. The software does not allow the client to add, edit, or delete data. The software does support the import of client reference data . . . into a limited set of fields to align with Taxpayer data, but Taxpayer must upload the data on behalf of the client. The software also contains a [standalone] function, which is the only function that allows clients to define and perform calculations. While most of the software's reports are standard, the software does allow the client to select from a set of standard fields in order to display certain fields or alter the arrangement of the fields in a given report. The client cannot download the software, nor does Taxpayer provide tangible or electronic copies of the software to its clients. Instead, the client uses its own web browser to access a URL that allows the client to access the software through the use of a password. Taxpayer's software is hosted on servers located outside the state of Indiana, and Taxpayer has exclusive control over the servers and the software. Taxpayer imposes a nontransferable, nonexclusive, revocable, limited right to access and use the software on its clients. Taxpayer provides each client with a copy of the license, but does not require its clients to sign the license agreement. Some clients do not actually use Taxpayer's software, relying on a data export from Taxpayer's system to enable analysis in the client's own systems. In addition, . . . clients [that] require Taxpayer to waive the charge for the use of the Taxpayer software or otherwise negotiate the amount the client will pay for the use of the software. As a result, Taxpayer's actual billing practices with respect to software usage may vary--even though all clients are contractually authorized to use the Taxpayer software. Taxpayer maintains processes that identify and update the geographic location of each software user, meaning that Taxpayer can identify the number of software users in Indiana versus software users everywhere. Finally, Taxpayer engaged a third-party valuation firm to determine the valuation of its software, and that firm identified the value as [a percentage] of Taxpayer's annual revenue.

DISCUSSION

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(c) goes on to provide in pertinent part:

For purposes of determining what constitutes selling at retail, it does not matter whether:
. . .
(2) the property is transferred alone or in conjunction with other property or services . . .

"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.

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 May 16, 2016), 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.

The first question involves the taxability of Taxpayer's coupon clearing service fee. As Taxpayer explained, it "acts as a coupon clearinghouse." After Taxpayer receives a batch of coupons, Taxpayer performs the following activities: separating the coupons; manually scanning the coupons; manually reviewing the coupons; analyzing the coupons through an automated system; applying the advertiser's payment policies (vis-à-vis the expiration date, exceptions, etc.); destroying the physical coupons it processed; transmitting data of the coupons to Taxpayer's servers; and tabulating payments that are owed by advertisers to retailers, transmitting the funds to retailers, and managing on-going funding requirements of advertisers. Taxpayer charges "a bundled base service fee that covers all or a portion of the[se] services." Part of the bundle sometimes includes providing access to "software that enables the client to run various reports to view the coupon and payment data applicable to the client." The question is whether this service is subject to Indiana sales tax.

Taxpayer maintains that "[a]lthough coupon clearing services are not enumerated as taxable, the Department could evaluate their taxability under the rules applicable to information services or data processing services." Data

processing services and information services are specifically distinguished from taxable telecommunication services as "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." IC 6-2.5-1-27.5(c)(3).

Regarding information services, Taxpayer refers to Sales Tax Information Bulletin #8 (November 2011) ("STIB 8"), which provides:

> The sale of statistical reports, graphs, diagrams, or any other information produced or compiled by a computer and sold or reproduced for sale in substantially the same form as they are so produced is considered to be the sale of tangible personal property unless the information from which such reports was compiled was furnished by the same person to whom the finished report is sold. The charge for reports compiled by a computer exclusively from data furnished by the same person for whom the data is prepared is considered to be for a service and is not subject to sales or use tax unless it is part of a unitary transaction subject to sales or use tax.
>
> **Note:** When statistical reports, graphs, diagrams, or any other information produced or compiled by a computer are transferred electronically to a customer, the transaction is not subject to sales tax. For more information on the application of Indiana sales tax to products transferred electronically, please refer to Section III below or Commissioner's Directive #41, available online at www.in.gov/dor/3617.htm.

In other words, producing information reports is generally nontaxable as a service. Commissioner's Directive #41 (December 2014) further clarifies that:

> Prior to the publication of this document, the department imposed sales and use tax on products transferred electronically based on whether the products were taxable in their tangible forms. However, to achieve compliance with the Streamlined Sales and Use Tax Agreement on a going-forward basis, the department may impose sales and use tax on products transferred electronically only if the products meet the definition of specified digital products, prewritten computer software, or telecommunication services.

Items transferred electronically are not subject to sales or use tax unless the products meet the definition of specified digital products, prewritten computer software, or telecommunication services.

Taxpayer believes the Department should not classify its base service activities as a taxable information service since the information used to enable Taxpayer's electronic reports was provided by the client and used by Taxpayer to produce electronic reports for use by the client. For these reasons, Taxpayer believes that its base service activities do not fall within any taxable enumerated service category in Indiana.

As mentioned above, coupons are transmitted to Taxpayer, which Taxpayer processes, reviews, and analyzes. After that, the Taxpayer makes available for its clients data gathered from this process so that its clients can run various reports from the data. This would fit in line with data processing or information services. The only provision of items that might be considered tangible personal property that could possibly render Taxpayer's service a taxable retail transaction pursuant to IC 6-2.5-4-1 would be either the reports or Taxpayer's software. With regard to the information reports, they would not fit under the definition of a "specified digital product," as these reports do not constitute a digital audio work, a digital audiovisual work, or a digital book. The reports would also not fit within the definition of "telecommunication service" or "computer software."

Since the summary reports would not be considered specified digital products, prewritten computer software, or telecommunication services, they would not subject Taxpayer's service to Indiana sales or use tax. Taxpayer's coupon clearing service appears to be a service under 45 IAC 2.2-4-2. Taxpayer charges a fee to its clients for customized information services. The Merchants do not pay a fee for individual reports, but a fee based upon the use of the coupon clearing services. Therefore, the reports would not render the coupon clearing service fee subject to Indiana sales and use tax.

The next question is whether Taxpayer's provision of software to its clients would render the service fee taxable, or, if there is a separate charge for the software, whether a standalone fee for software would be subject to Indiana sales and use tax. In addition to allowing Taxpayer's client to run reports, clients can use the software to arrange data, and it contains a function that allows clients to perform calculations. The software cannot be downloaded, and Taxpayer does not provide physical or electronic copies of the software to its clients. Clients access the software through a web browser and inputting a URL from Taxpayer's servers located outside Indiana. Taxpayer states that it "imposes a nontransferable, nonexclusive, revocable, limited right to access and use the

software on its clients."

Taxpayer does not always charge for its software. In a separate correspondence, Taxpayer broke out the possible scenarios in which it charges for its software as follows:

> a. The full value of the software access is bundled as part of the coupon clearing service fee. In this scenario, software usage is never a separate charge. This scenario represents 50% of our clients.
> b. The full value of the software access is a separate charge. In this scenario, none of the software usage is bundled as part of the coupon clearing service fee. This scenario is not common.
> c. Part of the software access is bundled and part is a separate charge. This scenario probably represents 40% of our clients. For this scenario, the portion of the software access value that is NOT covered by the separate charge will ultimately be "separately stated" at the bottom of our invoice (in a special section of our invoice that captures separately stated details).

Taxpayer also maintains that when it separately bills its software access charge, it is typically a low monthly amount, whereas the separate charges for the coupon clearing service would typically be a much higher amount each week.

With regard to the taxability of remotely accessed software, the Department in STIB 8 provides the following guidance:

> Prewritten computer software maintained on computer servers outside of Indiana also is subject to tax when accessed electronically via the Internet (i.e., "cloud computing"). The accessing of prewritten computer software by Indiana residents constitutes a transfer of the software because the customers gain constructive possession and the right to use, control, or direct the use of the software.

In a prior ruling (Ind. Rev. Ruling 2011-05ST (12/9/2011)), the Department concluded that a taxpayer's charges for online access to an information database were not taxable, but charges for the use of certain add-on remotely hosted software applications were taxable under the assumption that the customer obtained a possessory interest in the applications. With regard to the access to the database, the Ruling held that "Taxpayer's sales of access to its online database and its upgraded data packages via the Internet are not subject to Indiana sales and use tax." With regard to the workflow add-ons, however, the Ruling held that "customers are purchasing access to prewritten computer software for which they, the customers, have a possessory interest. On that basis, Taxpayer's sales of access to its workflow add-ons to end-user customers via the Internet are subject to Indiana sales and use tax when provided to customers located in Indiana."

Taxpayer reasons that the Department's analysis in Ruling 2011-05ST renders the taxpayer's software nontaxable. Taxpayer state's that the use of the "client-facing applications" is analogous to the software usage granted to customers as part of the exempt core service offering in Ruling 2011-05ST. As stated in the Ruling:

> "[Taxpayer's service] is an interactive, customizable web-based application that will offer users real-time access to [Taxpayer's] complete and up-to-date global database of... businesses for a subscription fee. [Taxpayer's] core service offering will allow customers to run searches and create customizable reports containing summary trade data, basic credit scores, legal filings, and general company information. For an additional fee, customers will be able to purchase upgraded data packages and workflow add-ons that provide additional data beyond that included with the base core service offering."

In the case at hand, Taxpayer's software only allows its clients to search and view data, run reports, and configure report templates to provide "custom" reports. Taxpayer's software does not enable clients to add, edit, or delete any of the data in the taxpayer's database. This basic platform has a similar functionality to the software that was treated as exempt access for database users in Ruling 2011-05ST. Essentially, the basic platform of the software is just to allow the client to access a database and run reports and calculations.

Further, the software serves the same function as the report generation activities discussed in STIB 8 in Issue 1 above, as the reports are compiled from information furnished by the same person for whom the finished report is produced via the software. Taxpayer's software is a reporting tool. The reports referenced in STIB 8 were generated by a computer that used reporting software analogous to the taxpayer's client-facing software.

Furthermore, the serviceperson test found at 45 IAC 2.2-4-2 applies in this instance. Taxpayer's software is available to Taxpayer's clients incident to the service provided, which is coupon processing. Taxpayer retains ownership of the software, and clients are only granted a limited right to access and use the software. 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 processing and analyzing coupons, and not selling tangible personal property. 45 IAC 2.2-4-2(a)(1). Second, the software is for the purpose of enabling Taxpayer's client to view the data Taxpayer has compiled and to run reports incident to Taxpayer's coupon clearing service. 45 IAC 2.2-4-2(a)(2). Third, the charges for the software relative to Taxpayer's overall service fee is inconsequential compared to the overall service fee, and is further mitigated when Taxpayer will sometimes waive the charge for the software altogether. 45 IAC 2.2-4-2(a)(3). Fourth, the software was created by Taxpayer, and thus Taxpayer did not have to pay sales tax when it was created or purchased. 45 IAC 2.2-4-2(a)(4).

Taxpayer has shown that its clients do not acquire the software for their own independent use, that they are granted a limited right to access the software, that the software functionality is limited and primarily provides access to data and information produced as part of the coupon clearing service, and the software is available to its clients incident to the service provided. For all of these reasons, the Department concludes that the fee for the software is exempt from Indiana sales and use tax if it is a standalone fee, and a bundled (or unitary) service fee that included the provision of the software is not subject to sales and use tax either. Since it was determined that the only provision of items that might be considered tangible personal property that could possibly render Taxpayer's service a taxable retail transaction pursuant to IC 6-2.5-4-1 would be the reports or Taxpayer's software, and both the reports and the software do not render the service fee taxable, Taxpayer's third, fourth, and fifth questions appear to be resolved without the need for further explanation.

RULING

Taxpayer's coupon clearing service fee is a nontaxable charge for a service. Taxpayer's provision of software is not subject to Indiana sales and use tax either, since it is provided as an incident to a service, and its functionality is limited primarily to accessing information assembled as a part of that service. As such, since the software is not subject to Indiana sales or use tax, the Department need not address Taxpayer's concerns regarding prospective treatment, or how a bundled or unitary charge would affect the service fee if software is also included.

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.

Posted: 10/26/2016 by Legislative Services Agency
An html version of this document.