DEPARTMENT OF STATE REVENUE

Revenue Ruling #2017-01ST
July 21, 2017

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ISSUES

Sales and Use Tax - Web Search Tools and Related Products

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; Grand Victoria Casino & Resort, LP v. Indiana Dep't of State Revenue, 789 N.E.2d 1041 (Ind. T.C. 2003); Asplundh Tree Expert Co. v. Indiana Dep't of State Revenue, 38 N.E.3d 744 (Ind. T.C. 2015); Sales Tax Information Bulletin #8 (December 2016); Revenue Ruling 2011-05ST, (December 9, 2011) 20111130 Ind. Reg. 045110713NRA; Streamlined Sales and Use Tax Agreement (December 23, 2016)

A taxpayer ("Company") is seeking an opinion as to whether Company is providing a service that is not subject to the Indiana sales and use tax.

STATEMENT OF FACTS

Company is an out-of-state corporation that connects shoppers with products by using its technology to "learn[ ]from the behavior of visitors to deliver the most relevant results possible, which directly drives increased sales and higher customer satisfaction." Company provides the following facts regarding its request for a revenue ruling:

Company Background and Description of Services

. . .

[Company] offers a number of services to its customers, of which the specific customer to which this [Private Letter Ruling ("PLR")] relates is using three services - [Product 1], [Product 2], and [Product 3]:

1. [Product 1]

[Company's] core product is [Product 1], an advanced SaaS search offering which is designed to learn from the customer's visitor's site search activity and click-throughs to deliver the most relevant results back to the visitor.

When a visitor performs a search on a [Company] customer's website, the results displayed are powered by [Company] and come from a [Company] server. The [Company] server is physically located outside of Indiana. To achieve this [Company] receives a "feed" from the customer - a file that contains all the information [Company] needs to build the search. Typically this information is a list of product information such as name, price, description and images. An updated feed is received regularly to ensure [Company] has the latest information.

[Product 1] is customized to match the design of the customer's existing website. The search results page is hosted by [Company], however it appears seamless to the customer's visitors. Clicking on results on the [Company]-powered search results page takes the visitor back to the relevant content on the customer's own website.

2. [Product 2]

[Product 2] is an add-on service for [Product 1], which shows visitors product images and descriptions in a drop-down box as they type. As the visitor types into the search box [Product 2] will constantly refresh the list of likely products and suggested terms. The content of [Product 2] is hosted by [Company].

3. [Product 3]

[Product 3] is a SEO (Search Engine Optimization) solution designed to drive more traffic to the customer's site. In general, the higher-ranked and more frequently a site appears in an internet search engine's results, the more visitors it will receive from the search engine's users.

[Product 3] is based on the logic that the search terms used on the internal site search to find products (as tracked by [Product 1]) are very similar to the terms used when searching the internet for those products. [Product 3] automatically creates pages based on commonly used site search terms to increase the chances that these pages will be picked up and ranked well by search engines. These [Product 3] pages created are hosted and managed on [Company's] servers, although they appear seamless to the client's site. Again, the [Company] servers are physical located outside of Indiana.

SaaS Solution

[Company] delivers its services SaaS model. With SaaS, the software and associated data is hosted outside the customer's premises and accessed through the internet. For reliability and scalability purposes we have data centers located around the globe . . . . Our redundant triple-location hosting ensures the highest uptime and protection for sites in any event.

Location of Services

Since all services provided to customers are cloud based, no physical control over the search results is maintained by the customers. Maintenance and upkeep of each of these services is operated by [Company] employees remotely outside of Indiana.

DISCUSSION

Based on the foregoing facts, Company requests a ruling as to whether it is providing a non-taxable service when it provides the three products described above. 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 December 23, 2016), of which Indiana is a signatory, "A member state shall not include any product transferred electronically in its definition of 'tangible personal property.'" Therefore, 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. Pursuant to the same section of the SSUTA, "ancillary services," "computer software," and "telecommunication services" are excluded from the term "products transferred electronically." This means prewritten computer software transferred electronically is still taxable. Additionally, 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 when they are intrastate, meaning "that the transmission must originate and terminate within Indiana." Grand Victoria Casino & Resort, LP v. Indiana Dep't of State Revenue, 789 N.E.2d 1041, 1045 (Ind. T.C. 2003). 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.

(**Emphasis added**).

With regard to the taxability of remotely accessed software, the Department in Sales Tax Information Bulletin #8 (December 2016) ("STIB 8") provides the following guidance:

> Whether a transaction involving the use of "cloud-based" software is subject to Indiana sales or use tax depends on the facts and circumstances of each transaction, particularly with regards to the amount of control or possession the purchaser is granted in the software, the object of the transaction, and the ownership rights, if any, the purchaser has in the software.

STIB 8 goes on to provide guidance with regard to situations where a vendor uses cloud-based software on a client's behalf:

> Depending on the factors of the transaction and arrangement, SaaS may or may not be subject to tax. Charges for accessing prewritten computer software maintained on the vendor's or a third party's computer or servers are not subject to tax when accessed electronically via the Internet if the customer is not transferred the software, does not have an ownership interest in the software, and does not control or possess the software or the server.

> > Example #3: An Indiana resident pays an hourly rate to utilize a vendor's software resources, which are maintained on the vendor's computer servers located outside of Indiana. The purchaser never uses, receives or has control of the software. Instead, the vendor uses the software to perform services on the Indiana resident's behalf. The transaction is not subject to sales tax.

> Further, a purchaser may contract with a business in order to receive services, and as part of those services, tangible personal property in the form of software is provided. If the software provided to the customer is merely incidental to the provision of services (less than 10% of the total price of the transaction), then the service transaction may not be subject to sales tax as a unitary transaction.

> > Example #4: An Indiana business contracts with a service provider who will perform the business's IT functions. As part of the service, the Indiana business downloads the service provider's prewritten software onto the business's computer. However, the Indiana business does not use the software; rather, the

service provider uses the software remotely in order to perform its IT services. The cost of the software is incidental (less than 10% of the total price of the transaction) to the service, so the transaction with the business customer is exempt from sales tax. The service provider, however, is subject to Indiana sales/use tax on the purchase of this software.

Even though software may be located outside Indiana, the Indiana Tax Court has indicated that something need not necessarily be physically present in Indiana for it to be "used" in Indiana. Asplundh Tree Expert Co. v. Indiana Dep't of State Revenue, 38 N.E.3d 744, 748 (Ind. T.C. 2015) (quoting Fisher & Co., Inc. v. Dep't of Treasury, 282 Mich.App. 207, 769 N.W.2d 740, 743 (2009). Further, the Court stated the following:

> Indiana's statutory definition of a taxable use is broad and leads to a very low threshold of taxability. See USAir Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466, 469 (Ind. Tax Ct.1993). Moreover, this Court has explained that the location of tangible personal property is not dispositive of whether the use tax applies because it would impermissibly limit the definition of a taxable use to either the intended or the ultimate use of the property. See id. at 471. . . . [T]herefore, the imposition of use tax does not necessarily depend on whether the subject property is physically present in the taxing state. Id.

To contextualize the guidance in STIB 8 with Company's software used to perform the services associated with the three products, Company points to a prior Revenue Ruling (Revenue Ruling 2011-05ST, (December 9, 2011) 20111130 Ind. Reg. 045110713NRA). In this Ruling, 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." Regarding 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," and that "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."

Differentiating its own software and products from those at issue in Revenue Ruling 2011-05ST, and applying the Department's guidance found in STIB 8, Company makes the following assertions:

1. Customers do not receive possession or control over the software.
2. Ownership rights are retained by Company.
3. The object of the transaction is services, not software.

STIB 8 provides additional guidance in order to determine whether a customer obtains an ownership interest in software:

> In order to determine whether a purchaser obtains a possessory or ownership interest in pre-written software, the following factors that indicate a possessory or ownership interest should be considered:
>
> • Whether the Indiana customer obtains or is granted the right to access or download copies of the software to the customer's own computers, servers, or network;
> • Whether the Indiana customer gains or is granted the right to modify or customize the pre-written software;
> • Whether the Indiana customer gains or is granted the right to make copies of the pre-written software for the customer's own use;
> • Whether the Indiana customer is required to pay additional amounts for enhancements, modifications, or updates to the software;
> • Whether the provider has a policy of providing a duplicate copy of the software at minimal or no charge if the customer loses or damages the software;
> • Whether the Indiana customer gains or obtains the right to use, deploy, or access the software for an unlimited or indeterminate period of time;
> • Whether the software must be returned or destroyed at the end of a specifically limited license period;
> • The relative price paid for accessing or using the software compared to the price charged for obtaining a possessory or ownership interest in that same, similar, or comparable software.
>
> In response to each factor listed above, Company provides the following assertions corresponding to the factors in order to establish that customers do not receive possession or control over any software:

- Section 4.2 of [Company's] Terms of Service (September 2008) expressly states, "In connection with the hosting services by [Company], [Company] hereby grants to Customer a worldwide, personal, limited and nonexclusive, license to access Services and related analysis tools provided thereby which are hosted on [Company] Systems owned or controlled computer or other networks."
- Section 9.2 of [Company's] Terms of Service (September 2008) expressly states, "A party must not disclose, copy or modify the other party's Confidential Information other than is necessary for executing its rights and performing its obligations under this Agreement."
- There is no right granted to [Company's] customers in the Terms of Service to copies for the customer's own use.
- [Company's] Terms of Service do not require payment for enhancements, modifications, or updates to the software. Specifically stated in Section 5.1 of [Company's] Terms of Service, "the customer further agrees and acknowledges that any modification of the way in which the Service or the [Company] Software shall be deemed the sole property of [Company]."
- This does not apply. [Company] does NOT "provide duplicate copies of the software at minimal or no charge if customer loses or damages the software." The software is maintained and hosted by [Company] in the cloud.
- The customer does NOT have the right to access the software for an unlimited or indeterminate amount of time. The software is used as part of the provision of services and access to that software terminates when the subscription of services is terminated.
- As previously stated . . . above, access to the software is hosted on [Company's] servers and that access can be terminated upon termination of the services agreement.
- The relative price paid for the services (and limited access to the software) is de minimis compared to the price that would be charged for an actual ownership interest in the software developed by [Company] and used to provide its services.

Further asserting that the ownership rights of the software are not transferred to its customers, Company again points to Section 5.1 of [Company's] Terms of Service, which provides:

> Except for the limited license provided for in this Agreement, the Customer acknowledges that the Customer does not acquire any intellectual property rights in the Services or the [Company] Software, including, by way of example only, in any patent rights, copyright, trade mark or design rights. The customer further agrees and acknowledges that any modification of the way in which the Service or the [Company] Software shall be deemed the sole property of [Company].

Company asserts that it primarily provides information technology services to its customers utilizing its own proprietary software. Customers are not provided "client-side software." Further, the Terms of Service provided by Company states that "[Company] provides the Services to the Customer [by Company] using proprietary software ("Company Software")." Per the Terms of Service, the services that [Company] provides the customer include "hosted search," "reporting tools," "indexing," "search results presentation," and "[Product 3] service." All of these services are provided by Company, with Company using its proprietary software. Company retains ownership of the software. Customers are not granted any rights to the software.

Applying the serviceperson test found at 45 IAC 2.2-4-2, Company satisfies all of the requirements of 45 IAC 2.2-4-2(a) for finding that the three products provided by Company are non-taxable. First, Company is primarily in the business of developing search engine and marketing strategies and providing business marketing, promotion, and consulting services, and not selling tangible personal property. 45 IAC 2.2-4-2(a)(1). Second, the software is used by Company in order to perform those services. 45 IAC 2.2-4-2(a)(2). Third, customers are not charged for the software, but are charged for the services provided by Company. 45 IAC 2.2-4-2(a)(3). Fourth, the software was created by Company, and thus Company did not have to pay sales tax when it was created or purchased. 45 IAC 2.2-4-2(a)(4). It is clear that Company's software is used by Company incident to the service provided.

Company has shown that customers are not granted any ownership rights to software, that the customers do not have possession or control over software, and that software is used by Company incident to the service provided, which is the object of the transaction. Company's products appears to be a service under 45 IAC 2.2-4-2, and not a sale, lease, license, or other transfer of software or other tangible personal property. Additionally, the products would not meet the definition of a "telecommunication service," which again is defined in IC 6-2.5-1-27.5 as "electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points." Company is transmitting, conveying, or routing information; however, "telecommunication services" does not include "[d]ata 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," which is what

Company's service performs.

Company provided examples of invoices for their products. In reviewing the documents provided, it does not appear that Company's customers are explicitly paying for software, but instead are charged fees based on the number of searches performed, fees for the number of websites utilized, or the number of referrals.

Based on the information provided, Company's products are not subject to sales or use tax, as they are nontaxable services.

RULING

Company provides services as enumerated in 45 IAC 2.2-4-2, using software incident to the services provided. Further, the services are not "telecommunication services." Therefore, these services are 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.

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