

DEPARTMENT OF STATE REVENUE

Revenue Ruling #2017-05ST
December 20, 2017

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ISSUES

Sales and Use Tax - Internet Based Product

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, 1045 (Ind. T.C. 2003); Revenue Ruling 2014-01ST, [20151125-IR-045150413NRA](#); *Streamlined Sales and Use Tax Agreement* (May 11, 2017).

A taxpayer ("Company") is seeking a determination as to whether an annual membership fee to use 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 annual fee for membership in the Product ("Product Membership") to Indiana customers subject to Indiana 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 Indiana sales and use tax?

STATEMENT OF FACTS

Company is a Washington state corporation that sells a variety of products over the internet. Company had previously requested a Revenue Ruling regarding this Product. The Department issued Company a Revenue Ruling (2014-01ST, [20151125-IR-045150413NRA](#); the "Prior Ruling") in response to this request on October 30, 2015. The facts and circumstances in this new request are substantially the same, except that the Product's membership benefits have been expanded to include three new features (the "Additional Benefits").

The following facts were provided with the request for the Prior 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 described in the Prior Ruling are still provided to Product Members. They 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.

The Additional Benefits provided to Product Members are described below:

- [Spoken Audio Streaming Channel] - [Product] Members receive access to a dynamic and distinctively organized selection of original programs, comedy, lectures, and audio editions of articles from the pages of The Wall Street Journal, The New York Times, Harvard Business Review, Foreign Affairs, McSweeney's and other leading periodicals. [Spoken Audio Streaming Channel] also showcases 20 hand-selected [Audiobook Retailer] Playlists, from essential stories of the day, meditation and commute-sized comedy to audio compilations focused on science, history, technology and more. With [Spoken Audio Streaming Channel] and a [Product]-exclusive selection of [Audiobook Retailer] audiobooks, the [Spoken Audio Streaming Channel] for [Product] benefit represents a remarkable value available free exclusively for [Product] members.
- [Reading Service] - In addition to [E-books Loaned for E-book Readers Benefit] and [Free E-Book Benefit],

[Product] Members receive access to unlimited reading from a rotating selection of books, magazines, comics, and more on their computers and devices ([E-Book Reader] devices or other devices with the [E-Book Reader] App).

- [Video Game Platform] - [Product] Members receive greater access to [Video Game Platform], the largest platform for video game players to broadcast streaming video of themselves playing video games and to interact with their viewers, recently integrated with [Product]. [Product] members receive free [Video Game Platform] channel subscriptions, discounts on game purchases, exclusive access to games and in-game content, and other perks.

Company also provided the following statement with its request for the Prior Ruling:

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 an updated ruling as to whether its Product Membership fee is still exempt from sales and use tax with the inclusion of the Additional Benefits, 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," as amended May 11, 2017), 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 Dept 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.

A one-year Product Membership provides Product Members access to many different benefits and features. Product Members pay a single annual fee, which allows them access to every feature and benefit that Product offers. 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. Applying the same analysis from the Prior Ruling in brief, there is a provision of software, but Company makes available for free the software their Product Members use with the Product Membership. Therefore, this would not constitute a retail sale and sales tax would not apply. Further, while Product Members for the most part do not have the right of permanent use of the specified digital products provided, in the case of the Free E-Book Benefit a customer may obtain a digital book for their permanent use. This single feature could trigger the taxability of the Product, and applying the serviceperson test at [45 IAC 2.2-4-2\(a\)](#) in order to determine whether the Product is primarily a unitary transaction involving a service, Company would fail the first part of the test, as Company is primarily a seller of tangible personal property.

Finally, Company's Product Membership services do not appear to 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, charges for delivery are subject to sales or use tax if the charges are not separately stated postage charges, but shipping is free for Product Members, and as such there would be no delivery charges when a Product Member orders an item for delivery (although 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 regarding the Additional Benefits, the Department concludes that, as in the Prior Ruling, the annual fee for a "Product Membership" is not subject to sales or use tax, as the transaction would not meet the definition of a retail transaction since no property is transferred for consideration upon the purchase of the annual fee. The inclusion of the Additional Benefits does not change the determination, as the payment of the annual fee still 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, and because a retail transaction must include some form of consideration, a free monthly trial would still also not be subject to sales or use tax. However, as before, 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

Even with the inclusion of Additional Benefits, the annual fee for Company's "Product Membership" still 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.

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