

Memorandum of Decision: 04-20181232R
Gross Retail Tax
For the Years 2014, 2015, 2016, and 2017

NOTICE: IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Memorandum of Decision.

HOLDING

Indiana Holding Company was entitled to a refund of sales tax paid on the purchase of Plex Systems computer software purchased during and subsequent to December 2016 because Holding Company purchased an interactive, web-based, exempt service; Holding Company was not entitled to a refund of tax paid on the purchase of computer software for which Holding Company acquired permanent ownership.

ISSUE

I. Gross Retail Tax - Computer Software.

Authority: IC § 6-2.5-1-27; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-4-16.7 (effective July 1, 2018); IC §§ 6-2.5-5 et seq.; IC § 6-2.5-13-1; *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Rhoads v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); [45 IAC 2.2-3-14\(2\)](#); [45 IAC 2.2-5-3\(b\)](#); [45 IAC 2.2-5-6\(a\)](#); [45 IAC 2.2-5-8\(a\)](#); [45 IAC 2.2-5-9\(a\)](#); [45 IAC 2.2-5-10\(a\)](#); Sales Tax Information Bulletin 8 (December 2016); Sales Tax Information Bulletin 8 (November 2011).

Taxpayer argues that the Department erred in denying Taxpayer a refund of sales tax paid to two different computer software vendors on the ground that Taxpayer was paying for exempt services.

STATEMENT OF FACTS

Taxpayer is an Indiana business which purchases, holds, and manages other companies. Taxpayer provides these "held" companies financial advice, technical expertise, and management support.

Taxpayer filed a form GA-110L, "Claim for Refund," seeking a refund of sales tax paid on a series of transactions with two different computer software providers. Taxpayer sought a refund of sales tax paid to Microsoft and Plex Systems on the ground that Taxpayer acquired exempt services from the two vendors. Taxpayer purchased one software product from Plex Systems and four different Microsoft software products including "SharePoint."

The Indiana Department of Revenue ("Department") reviewed the refund claim and issued a written report denying the refund. The Department found that Taxpayer was purchasing software licenses which authorized Taxpayer to access "canned" computer software. In addition, the Department's report noted that the licenses provided Taxpayer the right to various software updates and patches. As such, the Department's report concluded that Taxpayer was purchasing taxable software and taxable maintenance agreements.

Taxpayer disagreed with the Department's decision denying the refund and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Memorandum of Decision results.

I. Gross Retail Tax - Computer Software.

DISCUSSION

The issue is whether Taxpayer has established that - for each of the five series of retail transactions at issue - Taxpayer was purchasing exempt software services and that it was not purchasing "canned" computer software

and maintenance agreements subject to this state's sales and/or use tax.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). "When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location." IC § 6-2.5-13-1(d)(1). When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser . . . occurs" IC § 6-2.5-13-1(d)(2).

IC § 6-2.5-1-27 incorporates "prewritten computer software" in the definition of tangible personal property as follows:

"Tangible personal property" means 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.

A person who acquires property in a retail transaction (a "retail purchaser") is liable for the tax on the transaction. IC § 6-2.5-2-1(b).

Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a).

In effect and practice, the use tax is functionally equivalent to the sales tax. See *Rhoades v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

As a general rule, all purchases of tangible personal property - including computer software - are subject to sales or use tax unless specifically exempted by statutes or regulations. [45 IAC 2.2-5-3\(b\)](#); [45 IAC 2.2-5-6\(a\)](#); [45 IAC 2.2-5-8\(a\)](#); [45 IAC 2.2-5-9\(a\)](#); [45 IAC 2.2-5-10\(a\)](#). Various tax exemptions are outlined in IC §§ 6-2.5-5 et seq. which are applicable to both sales tax and use tax. [45 IAC 2.2-3-14\(2\)](#). A statute which provides any tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 101 (internal citations omitted). In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). When a taxpayer challenges the taxability, the taxpayer is required to provide documentation explaining and supporting its challenge. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). When an agency is charged with enforcing a statute, the jurisprudence defers to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014).

Taxpayer explains the five series of transactions at issue:

- Plex Systems Plan 1: "The Plex software as a service manufacturing platform that collects granular information from your shop floor to each manufacturing moment and provides intelligence to use that data to make faster and more informed business decisions."
- Microsoft Plan 1: "A hosted messaging solution that delivers the capabilities of Microsoft Exchange Server as a cloud based service."
- Microsoft Plan 2 (*Microsoft Intune*): "A cloud-based enterprise mobility management service that helps enable productivity and protect data."
- Microsoft Plan 3 (*Office 365 Enterprise E1*): "A collection of Web-based tools and technologies that help store, share, and manage digital information."
- SharePoint Online Plan 1: A collection of Web-based tools and technologies that help store, share, and manage digital information."

For reference sake, it should be noted that the Indiana General Assembly recently promulgated an amendment to the Indiana code, IC § 6-2.5-4-16.7 (effective July 1, 2018) which provides in part:

- (a) Except as provided in subsection (b), a person is a retail merchant making a retail transaction when the person sells, rents, leases, or licenses for consideration the right to use prewritten computer software delivered electronically.
- (b) A transaction in which an end user purchases, rents, leases, or licenses the right to remotely access prewritten computer software over the Internet, over private or public networks, or through wireless media:
 - (1) is not considered to be a transaction in which prewritten computer software is delivered electronically; and
 - (2) does not constitute a retail transaction.

IC § 6-2.5-4-16.7 is irrelevant to the protest at hand because the transactions at issue each took place before July 1, 2018, and IC § 6-2.5-4-16.7 has no "look back" effect.

A. December 2016 Sales Tax Information Bulletin 8.

Taxpayer argues that the five transactions at issue are not subject to sales/use tax because it never gained a possessory interest in any of the software. For purchases which took place December 2016 and after, the issue Taxpayer raises is addressed in Sales Tax Information Bulletin 8 (December 2016), 20170125 Ind. Reg. 045170026NRA, available at <http://www.in.gov/dor/reference/files/sib08.pdf> (last visited May 28, 2018).

The Bulletin serves as a useful guide to determine whether similar software transactions were subject to Indiana sales/use tax. Sales Tax Information Bulletin 8 (December 2016) explains, in relevant part, as follows:

The taxability of software that can be electronically accessed via the internet, either by remote access from a hosted computer or server or through a pool of shared resources from multiple computers and servers ("cloud computing"), without having to download the software to the user's computer, is not specifically addressed in the Indiana Code. 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.

Depending on the factors of the transaction and arrangement, SaaS [Software as a Service] 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.

...

Prewritten computer software purchased by an Indiana taxpayer, which is accessed by the Indiana taxpayer from the vendor's or a third party's computer servers electronically via the internet from the taxpayer's computer could constitute a transfer of the software because the taxpayers gain constructive possession and the right to use, control, or direct the use of the software. As such, this transaction would be subject to sales tax

As such, remotely accessed software may or may not be subject to the state's sales/use tax depending on the degree control or possession the buyer exerts over the software; i.e. is the purchaser buying software or is the purchaser paying for the right to make use of software that belongs to someone else? In order to make that determination, Sales Tax Information Bulletin 8 provides as follows:

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.

B. November 2011 Sales Tax Information Bulletin 8.

Because Taxpayer's transactions occurred during 2014, 2015, 2016, and 2017, the software issues are also addressed by reference to Sales Tax Information Bulletin 8 (November 2011), 20111228 Ind. Reg. 04110765NRA. That prior Bulletin - effective November 2011 to December 2016 - included a provision relevant as follows:

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.

Since Taxpayer's software transactions straddle the periods under which the two Bulletins operated, software accessed by means of the Internet may or may not be subject to sales tax and requires analysis of both Bulletins. Under the 2011 Bulletin, remotely accessed software is subject to tax regardless of whether the software constitutes a service or whether the software user has a degree of ownership in the software.

Under the 2016 Bulletin, remotely accessed software may be subject to sales tax if the circumstances specifically point to a degree of "constructive" ownership of the software.

C. Plex Systems, Inc.

The "service agreement" between Plex Systems and Taxpayer defines the terms under which Taxpayer licensed the software. The agreement grants and limits the rights of the two parties. The agreement provides that Plex Systems will provide Taxpayer:

[A]pplication modules as a service which allows authorized users to login, navigate menus, view and update data, run reports, and interact with online information operated and maintained by Plex.

Taxpayer adds its own data to the Plex system but the agreement provides that Taxpayer "remain[s] the sole and exclusive owner of all Customer Data." The Plex software modules are made accessible to Taxpayer "through an up-to-date Microsoft Web Browser running over a standard Internet connection"

Plex guarantees that its software modules will be available no less than 99.9 percent of the time with Plex providing system upgrades and fixes at no charge to Taxpayer.

In return for paying the monthly subscription fee, Plex system grants to Taxpayer "an ongoing, non-exclusive, non-transferable right to access and use the Plex online service" However, the agreement between Plex and Taxpayer precludes Taxpayer - either directly or indirectly - from allowing third-parties access to the Plex online service or from "market[ing] or resell[ing]" access to the Plex service.

If Taxpayer fails to pay the monthly access fee, Plex retains "at its sole option" the right to terminate the agreement and Taxpayer's access to the platform upon 60 days' written notice.

In all cases, the agreement provides that:

Plex retains sole ownership of the Plex Online source code including, without limitation, any and all enhancements, modifications, screen rendered using Plex proprietary rendering engines adaptations and/or derivative works of the foregoing, whether made by Plex, [Taxpayer] or the parties jointly.

Under the terms of the parties' agreement, Taxpayer retained ownership of its own data managed, stored, and

manipulated by the Plex software, but Plex retained ownership of its own software modules which performed those functions. Taxpayer made monthly payments in order to access Plex's software modules, but Plex retained sole and exclusive ownership of the modules along with the right to terminate Taxpayer's access to the software. The Taxpayer in this case did not have constructive possession, and the payments made to Plex subsequent to December 2016 were not subject to Indiana's sales tax and Taxpayer is entitled to a refund of the sales tax paid pursuant to the Plex/Taxpayer agreement.

However, payments made to Plex prior to the effective date of December 2016 Bulletin are governed by Sales Tax Information Bulletin 8 (November 2011). That 2011 Bulletin is a blunt instrument on the issue of remotely accessed software. That earlier Bulletin makes no distinction between software which functions solely as a "service" and between software for which the buyer gains a defined gradient of "constructive" possession. It simply provides that:

Prewritten computer software maintained on computer servers outside of Indiana also is subject to tax when accessed electronically via the Internet . . . 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 other words, the November 2011 Bulletin simply provides that remotely accessed software is subject to tax because remote access of the software always constitutes "constructive possession."

To the extent that Taxpayer purchased Plex software during and subsequent to December 2016, Taxpayer's protest is sustained because the software is clearly a service for which the agreement provides Taxpayer no degree of constructive ownership in the software itself. To the extent that Taxpayer purchased Plex software prior to December 2016, the taxability is governed by the 2011 agreement and - because Taxpayer remotely "accessed" the software - Taxpayer's protest is respectfully denied.

D. Microsoft Products.

The four Microsoft purchases are covered under a single master purchase agreement. Under the master agreement, Microsoft sells "licenses" for each of its products which allows Taxpayer "the right to run the version of the product ordered." Microsoft defines its products as anything "Microsoft makes available for License for a fee, including online services and other web based services."

Once the purchaser acquires and pays for each license, the purchaser is entitled to "run as many available Products as desired . . ." as long as the purchaser has "completed all payments." If the purchaser pays for the license, it is also entitled to run an "earlier version of the Product" and is entitled to "sublicense the right to use the Product to [purchaser's] Affiliates"

The master agreement provides that the purchaser's right to use the licensed product "becomes permanent once the License term ends and Customer has completed all payments." Elsewhere, the master agreement states the license to use the product "becomes perpetual at the end of the term during which they were ordered or on the date on which the Customer completes all payments for those Licenses"

The agreement allows the customer to "make as many copies as it needs" and grants the customer - under certain circumstances - "re-imaging rights."

In the case of the Microsoft products, the Department recognizes that the products are interactive and may - in part or in whole - accessed by means of the Internet. However as explained in Sales Tax Information Bulletin 8, remotely accessed software may or may not be subject to sales tax depending upon the degree of control or possession the buyer exerts over the software. The Microsoft master agreement clearly grants Taxpayer a substantial degree of ownership over the software licenses Taxpayer acquired from Microsoft including a limited right to transfer the software, copy the software, and - most significantly - a "perpetual" and "permanent" right to that software. Bearing in mind that the exemption Taxpayer seeks is "strictly construed in favor of taxation and against the exemption." *Kimball Int'l Inc.*, 520 N.E.2d at 456, the Department is unable to agree that Taxpayer has established that the Microsoft purchases fall within the exemption.

FINDING

Taxpayer's protest is sustained in part and denied in part; Taxpayer is entitled to a refund of the sales tax paid on the purchase of the Plex Systems computer software during and subsequent to December 2016 but is not entitled to a refund of tax paid on the purchase of the Microsoft products.

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