DEPARTMENT OF STATE REVENUE

04-20181733R.MOD

Memorandum of Decision: 04-20181733R
Gross Retail and Use 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

Telephone Company was not entitled to a refund of sales tax paid on the purchase of computer software purchased from out-of-state vendors and delivered to Indiana; Indiana law provided a "temporary storage" exemption for use tax but not sales tax. Telephone Company was not entitled to an apportioned refund of sales tax paid on the purchase of software maintenance agreements based on the ratio of its in-state and out-of-state employees.

ISSUES

I. Gross Retail and Use Tax - Computer Software.

Authority: IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-1(d); IC § 6-2.5-3-2(a); IC § 6-2.5-3-2(e); IC §§ 6-2.5-5 et seq.; IC § 6-2.5-9-3; IC § 6-2.5-13-1; IC § 6-2.5-13-1(d); IC § 6-2.5-13-1(d)(1); IC § 6-2.5-13-1(d)(2); IC § 6-2.5-13-2 (repealed 2009); *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind.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); *Rhoade 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).

Taxpayer argues that the Department erred in denying Taxpayer a refund of tax paid on the purchase of computer software claiming that the software was accessed and used by numerous of its employees located outside Indiana.

II. Gross Retail and Use Tax - Exempt Central Office Telecommunications Equipment.

Authority: IC § 6-2.5-5-13; *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988); 45 IAC 2.2-5-20.

Taxpayer states that it is entitled to a refund of sales and use tax paid on the purchase of equipment and supplies which were destined for deployment in one of its central offices facilities.

III. Gross Retail and Use Tax - Temporary Storage Exemption.

Authority: IC § 6-2.5-3-1(a); IC § 6-2.5-3-1(d); IC § 6-2.5-3-2(e).

Taxpayer maintains that it is entitled to a refund of tax paid on the purchase of equipment and supplies which were purchased for delivery to Indiana but which were ultimately intended for use at Taxpayer locations outside Indiana.

IV. Gross Retail and Use Tax - Unremitted Sales/Use Tax.

Authority: IC § 6-2.5-3-5.

Taxpayer argues that it is not subject to Indiana sales or use tax on purchases where it can establish that it paid Indiana sales tax to the original vendor.

V. Gross Retail and Use Tax - Software Maintenance Agreements.

Authority: IC § 6-2.5-13-2 (repealed 2009); IC § 6-2.5-4-17; Sales Tax Information Bulletin 8 (December 2016).

Taxpayer states that it is entitled to an apportioned refund of sales or use tax paid on the purchase of software maintenance agreements based on a comparison of the number of its in-state and its out-of-state employees.

STATEMENT OF FACTS

Taxpayer is an out-of-state communications company which conducts business in Indiana. Taxpayer provides data, Internet, network access, and local and long distance phone services to customers in and outside Indiana. Taxpayer also sells video services, telecommunications equipment, and data center services.

Taxpayer submitted a refund request seeking the return of sales and use tax. The Indiana Department of Revenue ("Department") reviewed the refund claim and partially granted and partially denied that claim. Taxpayer disagreed with that portion of 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 and Use Tax - Computer Software.

DISCUSSION

The issue is whether Taxpayer has established that it is entitled to a refund of sales/use tax paid on the purchase of computer software licenses destined to be accessed and used by employees both inside Indiana and outside Indiana. Taxpayer concludes that it is entitled to a refund of an "apportioned" amount of the tax based on a comparison between the number of employees located outside Indiana and the number of users located inside Indiana.

The Department's investigation of Taxpayer's refund claim found that the software licenses were first delivered to Taxpayer's Indiana location and that there was no evidence that the software was delivered "electronically" to locations outside Indiana. In addition, the Department's audit found no evidence that Taxpayer paid "use" tax to states in which its out-of-state employees made use of the software licenses.

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 subject to tax:

> "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 generally functionally equivalent to the sales tax. See *Rhoade 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 purchased computer software from companies such as Zones, Bitbucket, JIRA, Atlassian, and Confluence. Taxpayer explains that some of the software is "flexible software to streamline development processes." Other software is used in the operational and management aspects of its business. However as Taxpayer explained, "[A]ll software related invoices have an Indiana 'ship to' address although the benefit of the software licenses is realized throughout multiple states." Taxpayer provided documentation intended to establish that most of the software is utilized by only a small number of its Indiana employees. According to Taxpayer, "4[percent] of Taxpayer's employees are located within Indiana, and for that reason only 4[percent] of the software license cost should be sourced to Indiana." Given those numbers, Taxpayer states that it is entitled to a refund of approximately $940,000 in sales tax by comparing the number of its Indiana employees with the total number of its employees.

Taxpayer suggests that it is entitled to the requested refund under the "Multiple Point of Use" (MPU) statute, IC § 6-2.5-13-2 (repealed 2009) which formerly provided:

> Notwithstanding section 1 of this chapter, a business purchaser that:
> (1) is not a holder of a direct pay permit; and
> (2) knows at the time of purchase of a digital good, computer software delivered electronically, or a service that the digital good, computer software delivered electronically, or service will be concurrently available for use in more than one (1) jurisdiction; shall deliver to the seller in conjunction with its purchase a form disclosing this fact ("multiple points of use" or "MPU" exemption form.)
>
> (b) Upon receipt of the MPU exemption form, the seller is relieved of all obligation to collect, pay, or remit the applicable tax and the purchaser shall be obligated to collect, pay, or remit the applicable tax on a direct pay basis.
>
> (c) A purchaser delivering the MPU exemption form may use any reasonable, but consistent and uniform method of apportionment that is supported by the purchaser's business records as they exist at the time of the consummation of the sale.
>
> (d) The MPU exemption form remains in effect for all future sales by the seller to the purchaser (except as to the subsequent sale's specific apportionment that is governed by the principle of subsection (c) and the facts existing at the time of the sale) until it is revoked in writing.

However, Taxpayer's reliance on the MPU provision is unfounded because the MPU provision was repealed January 1, 2009.

Instead Taxpayer apparently relies on the Indiana use tax "temporary storage exemption" found at IC § 6-2.5-3-2(e).

That statute provides:

> (e) Notwithstanding any other provision of this section, the use tax is not imposed on the keeping, retaining, or exercising of any right or power over tangible personal property, if:
> (1) the property is delivered into Indiana by or for the purchaser of the property;

(2) the property is delivered in Indiana for the sole purpose of being processed, printed, fabricated, or manufactured into, attached to, or incorporated into other tangible personal property; and
(3) the property is subsequently transported out of state for use solely outside Indiana.

IC § 6-2.5-3-1(d) provides the definition of "temporary storage." That provision states:

> "Temporary storage" means the keeping or retention of tangible personal property in Indiana for a period of not more than one hundred eighty (180) days and only for the purpose of the subsequent use of that property solely outside Indiana.

Plainly the statute applies the exemption to "use tax." Of course, to the extent that Taxpayer paid "sales" tax to local, Indiana vendors, the exemption is inapplicable because there is simply no "temporary storage" exemption for sales tax.

Nonetheless, Taxpayer apparently argues that it paid "use" tax to out-of-state vendors who collected Indiana tax on behalf of the state. Taxpayer's analysis is incorrect.

Anytime a remote vendor - who has sales tax nexus with a state - enters into a retail transaction that is completed in that state - i.e., the tangible personal property is either accepted or delivered into that state - the vendor has an obligation to collect and remit *sales* tax on all the retail transactions. IC § 6-2.5-2-1; IC § 6-2.5-13-1; IC § 6-2.5-9-3. Here, any out-of-state software vendor selling to customers within Indiana have "substantial contacts" with Indiana and thus also have Indiana sales tax nexus. The obligations of a registered retail merchant with Indiana sales tax nexus to collect Indiana sales tax are outlined in IC § 6-2.5-13-1, the general sourcing statute, which, in relevant part, provides:

> (d) The **retail sale**, excluding lease or rental, **of a product shall be sourced** as follows:
> (1) When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location.
> (2) 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 (or the purchaser's donee, designated as such by the purchaser) occurs, including the location indicated by instructions for delivery to the purchaser (or donee), known to the seller**. (**Emphasis added**).

Taxpayer purchased software from out-of-state vendors which were either "delivered/shipped to" or installed at Taxpayer's Indiana location. Thus, the out-of-state vendors conducted business in Indiana by making Indiana retail transactions with Indiana residents. The retail transactions were completed when the items were delivered to Taxpayer's Indiana address. Because the sales occur in Indiana, any out-of-state vendors who sold and delivered software to Indiana customers are required to collect Indiana sales tax.

Even though Taxpayer's employees utilize the software both inside and outside Indiana, Taxpayer is not entitled to a refund of *sales* tax paid to out-of-state vendors because Indiana law does not contain a temporary storage *sales* tax exemption.

FINDING

Taxpayer's protest is respectfully denied.

II. Gross Retail and Use Tax - Exempt Central Office Telecommunications Equipment.

DISCUSSION

Taxpayer argues that it is entitled to a refund of sales/use tax paid on the purchase of equipment and supplies destined for use in one of its "central offices." Taxpayer claims an exemption on "[c]entral office and related telecommunications equipment [employed] to provide, support and maintain [its] telecommunications services."

In initially reviewing Taxpayer's refund request, the Department found that the equipment "was not titled as telecommunications equipment in the original claim" and that Taxpayer provided no "documentation or chart of accounts to determine if the equipment or software purchases were telecommunications equipment."

Taxpayer cites to IC § 6-2.5-5-13 which states:

Transactions involving tangible personal property are exempt from the state gross retail tax, if:
(1) the property is:
(A) classified as central office equipment, station equipment or apparatus, station connection, wiring, or large private branch exchanges according to the uniform system of accounts which was adopted and prescribed for the utility by the Indiana utility regulatory commission;
(B) mobile telecommunications switching office equipment, radio or microwave transmitting or receiving equipment, including, without limitation, towers, antennae, and property that perform a function similar to the function performed by any of the property described in clause (A); or
(C) a part of a national, regional, or local headend or similar facility operated by a person furnishing video services, cable radio services, satellite television or radio services, or Internet access services; and
(2) the person acquiring the property:
(A) furnishes or sells intrastate telecommunication service in a retail transaction described in IC 6-2.5-4-6; or
(B) uses the property to furnish:
(i) video services or Internet access services; or
(ii) VOIP services.
(*Effective July 1, 2009*).

The Department's regulation, 45 IAC 2.2-5-20, outlines in detail the numerous items which are classified as "Central Office Equipment" including everything from batteries to desks to aisle lighting equipment.

It is apparent from both the regulation and the statute, that the exemption covers a broad swath of materials, supplies, and equipment. However, Taxpayer's supporting documentation and equipment descriptions are ambiguous. In some cases the referenced invoice simply describes a project number (2357022), "work performed," "building maintenance," a lengthy string of serial numbers (SFCW1833COXB), or "maintenance support." In other words, the information provided does not identify the equipment at issue and gives no clue that the equipment is destined for use in one of Taxpayer's central offices. Given that IC § 6-2.5-5-13 - along with each and every exemption - is "strictly construed in favor of taxation and against the exemption," it is not possible to sustain Taxpayer on this issue and to grant the requested refund. *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

FINDING

Taxpayer's protest is respectfully denied.

III. Gross Retail and Use Tax - Temporary Storage Exemption.

DISCUSSION

Taxpayer argues that it is entitled to a refund of tax paid on the purchase of items which were sent to Indiana, modified for Taxpayer's own purposes, and then "placed in use out of the state." Taxpayer explains that this "equipment is new and cannot be placed into service in Taxpayer's network immediately after purchase." Taxpayer stated that its Indiana employees:

[P]erform[] configuration changes and software updates and prepares the equipment for site installation.

As authority for its position, Taxpayer cites to IC § 6-2.5-3-2(e) which provides:

(e) Notwithstanding any other provision of this section, the use tax is not imposed on the keeping, retaining, or exercising of any right or power over tangible personal property, if:
(1) the property is delivered into Indiana by or for the purchaser of the property;
(2) the property is delivered in Indiana for the sole purpose of being processed, printed, fabricated, or manufactured into, attached to, or incorporated into other tangible personal property; and
(3) the property is subsequently transported out of state for use solely outside Indiana.

IC § 6-2.5-3-1(d) provides the definition of "temporary storage." That provision states:

"Temporary storage" means the keeping or retention of tangible personal property in Indiana for a period of not more than one hundred eighty (180) days and only for the purpose of the subsequent use of that property solely outside Indiana.

As noted in Part I above, the exemption is applicable only to "use tax" and that there is no "temporary storage" sales tax exemption. In addition, as explained in Part I, out-of-state vendors who have chosen to collect tax on behalf of the state are collecting "sales" tax and not "use" tax. Taxpayer errs in its reliance on IC § 6-2.5-3-2(e).

However, even if Taxpayer had self-assessed use tax on the purchase of this equipment, the Department points out that the exemption applies in instances in which the items were brought into the state "only for the purpose of the subsequent use of that property outside Indiana." IC § 6-2.5-3-1(d). The statute defines "use" as the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). While the property was in Indiana, Taxpayer exercised "use" of that property. As Taxpayer explained, "[Its] Indiana team performs configuration changes and software updates, and prepares the equipment for site installation" and "the equipment in question is modified before it is shipped outside Indiana."

In short, the Department stands by the position that the out-of-state vendors collected "sales" tax and that the temporary storage exemption is applicable only to "use tax." However even if Taxpayer had self-assessed use tax, the sought-after exemption is only relevant if the property is temporarily brought into the state *solely* for the purpose of use outside Indiana. In this case, the property was brought into the state for the purpose of adapting, modifying, and making it fit for use in Taxpayer's statewide telecommunication system.

FINDING

Taxpayer's protest is respectfully denied.

IV. Gross Retail and Use Tax - Unremitted Sales/Use Tax.

DISCUSSION

Taxpayer argues that it is not subject to sales/use tax on purchases for which it can establish it paid tax to the original vendor.

Without stating as much, Taxpayer apparently relied on IC § 6-2.5-3-5 as a basis for its argument. The statute provides:

> A person is entitled to a credit against the use tax imposed on the use, storage, or consumption of a particular item of tangible personal property equal to the amount, if any, of sales tax, purchase tax, or use tax paid to another state, territory, or possession of the United States for the acquisition of that property.

Taxpayer provided invoices and billing information from Michael Kinder & Sons, Inc. (MKS), Fort Wayne, Indiana; CDW Direct, Chicago, Illinois; Tektronix Communications, Plano, Texas; and C.M.S. Roofing, Inc. Fort Wayne, Indiana; and Netscout, Plano, Texas. Each of the invoices establish that Taxpayer was billed for and paid sales tax to the original vendor.

The Department's original audit review states, "There were invoices that the vendor collected another State sales tax and not Indiana's."

Of course, if any of these Indiana vendors collected Indiana sales tax but failed to remit it to the state, that issue is a matter between the vendor and the Department. But in this - and to the extent that the Department charged Taxpayer sales tax on any of the transactions at issue - Taxpayer is entitled to the relief sought in the form of credit for the tax paid.

FINDING

Taxpayer's protest is subject to the Audit Division's review of the invoices submitted by Taxpayer.

V. Gross Retail and Use Tax - Software Maintenance Agreements.

DISCUSSION

The issue is whether Taxpayer has established that it is entitled to a refund of sales/use tax paid on the purchase of software maintenance agreements.

The Department's audit considered Taxpayer's claim that the maintenance agreements were exempt from sales/use tax. As explained in the audit report:

> Invoices reviewed for purchases of services revealed that sales tax was charged on tangible personal property and not services. These transactions included software and hardware maintenance contracts. The substance of the agreement is tangible personal property in the form of software updates will be provided no matter what the language of the contract says. . . . . In the case of software maintenance agreements, it is clear that the parties presume that tangible personal property in the form of updates will be transferred.

Taxpayer argues that it is entitled to an apportioned amount of the sales/use tax paid on the purchase of software maintenance agreements. Taxpayer's position is that the beneficiaries of these agreements - its in-state employees and out-of-state employees - are found in both Indiana and in locations outside Indiana.

Indiana law, IC § 6-2.5-4-17, provides:

> A person is a retail merchant making a retail transaction when the person enters into a computer software maintenance contract to provide future updates or upgrades to computer software. (*Effective July 1, 2010*).

Going forward, and for Taxpayer's future reference, the Department notes that the most recent version of Sales Tax Information Bulletin 8 (December 2016), 20170125 Ind. Reg. 045170026NRA, states in small part:

> A person is a retail merchant making a retail transaction when the person enters into a computer software maintenance contract to provide future updates or upgrades to computer software. These contracts are therefore subject to sales tax.

In this case, Taxpayer is paying for software maintenance agreements in order to maintain and update software used by Taxpayer's in-state and out-of-state employees. Taxpayer states that it is entitled to rely on the "multiple point of use" (MPU) standard to apportion the sales tax between its in-state employees and out-of-state employees because the underlying software is used with both sets of employees. However, the MPU standard as set out in IC § 6-2.5-13-2 was repealed in 2009. In the case of these unitary taxable transactions, there is simply no avenue by which the tax liability is apportionable based on the relative number of in-state and out-of-state employees who access the software.

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

Taxpayer has established that it paid sales tax on a limited number of its purchases and has provided invoices verifying payment. Subject to the results of the Audit's Division review of those invoices, Taxpayer is entitled to a "credit" for the tax paid. In all other respects, Taxpayer's protest is denied.

February 13, 2019

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