DEPARTMENT OF STATE REVENUE

04-20181873.LOF

Letter of Findings: 04-20181873
Gross Retail and Use Tax
For the Years 2014, 2015, and 2016

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Indiana Retail Store Chain was subject to sales and use tax on the purchase of computer software subsequently accessed by Retail Store Chain's users located both inside Indiana and outside the state; the Department found no basis for allowing an exemption for software maintenance agreements which provided for software upgrades, patches, and fixes.

ISSUE

I. Gross Retail and Use 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 §§ 6-2.5-5 et seq.; IC § 6-2.5-13-1(d)(1); IC § 6-2.5-13-1(d)(2); IC § 6-8.1-5-1(c); *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *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); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *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 2.2-3-16; 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 (November 2011).

Taxpayer argues that the Department erred in assessing sales and use tax paid on the purchase of computer software claiming that the software was accessed and used by many of its employees located outside Indiana.

STATEMENT OF FACTS

Taxpayer is an Indiana company which operates a nation-wide chain of retail stores. Taxpayer operates multiple locations throughout the United States including locations in Indiana. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer's financial records, purchases, and tax returns. Because of the substantial number of purchases, the Department and Taxpayer agreed to review a "sample" of those transactions.

The Department's audit resulted in a proposed assessment of additional sales and use tax. Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Gross Retail and Use Tax - Computer Software.

DISCUSSION

The issue is whether Taxpayer has established that it was not required to pay sales or use tax on the purchase of pre-written computer software and associated software maintenance agreements.

A. Taxpayer's Burden of Proof.

Because the audit resulted in an assessment of additional tax, it is the Taxpayer's responsibility to establish that the assessment which includes interest, penalty, and tax is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of

proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

When a taxpayer challenges taxability in a specific instance, 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).

B. Indiana's Gross Retail 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).

C. Indiana's Complimentary Use Tax.

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).

D. Computer Software and Indiana's Sales and Use Tax.

IC § 6-2.5-1-27 incorporates "prewritten computer software" in the definition of tangible personal property subject to sales and use 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).

E. Sales and Use Tax Exemptions.

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).

Throughout the protest, Taxpayer argued that its purchases of "pre-written software licenses from various vendors" were not taxable. This determination addresses Taxpayer's arguments as follows:

F. Taxpayer's Software Purchases.

1. GXS Inc.

Taxpayer explains that it purchased pre-written computer software from a company called GXS Inc. The Department's audit found that the software was subject to sales and use tax. The audit explained as follow:

> [The] software from GXS . . . gave the [T]axpayer control to input item price and detail information. The software is connected with the cloud and can be accessed by the [T]axpayer's other locations.

Taxpayer disagrees stating that the expense is a "non-taxable subscription fee." According to Taxpayer, payment of the fee permits Taxpayer:

> [T]o handle electronic data interchange [] transactions between [Taxpayer] and its vendors. This service facilitates [Taxpayer] to electronically exchange transactions to allow for more efficient and timely payment of accounts payable invoices. The service reduces the necessity for manual checks to be issued. This is an on line data base subscription [and] is deemed nontaxable.

Elsewhere, Taxpayer states that it is paying for "digital space in order to store or back-up a customer's data and information" and that GXS's provision of "access to the customer's own software, data, or information is not subject to Indiana's sales or use tax regardless of the manner or location in which the software, data, or information is stored."

Taxpayer states that it has no ownership interest in the software provided by GXS. However, the agreement between Taxpayer and GXS would appear at odds with that proposition. The contract provides as follows:

> With regards to the materials produced as a result of professional services hereunder or under any statement of work, GXS grants to [Taxpayer] a perpetual, irrevocable, non-exclusive, royalty-free license to use such materials in connection with [Taxpayer's] use of the Services.

Ownership interest or not, the Department's guidance on this issue is found at Sales Tax Information Bulletin 8 (November 2011), 20111228 Ind. Reg. 045110765NRA, (*superseded by Sales Tax Information Bulletin 8 (December 2016)*), which was in effect at the time of the transactions and is dispositive of the GXS software issues raised here by Taxpayer.

> 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.

Neither the Department nor Taxpayer need resort to rarefied explorations of the underlying nature, function, or use of the software. The Bulletin is clear; remotely accessed computer software is "tangible personal property" and subject to the state's sales and use tax. In this case, the Department does not agree that the payments to GXS Inc. are exempt from Indiana's sales and use tax.

2. iAnywhere Solutions (a/k/a Sybase).

Taxpayer purchased pre-written computer software from a vendor called iAnywhere Solutions. The Department's audit found that the software was subject to sales and use tax explaining as follows:

> [T]axpayer purchased cloud based software with the control in Indiana . . . .
>
> Since these transactions are prewritten software and the [T]axpayer has constructive possession, all purchases from [iAnywhere] are subject to use tax . . . .

Taxpayer disagrees stating the iAnywhere purchases are for "cloud based software that is not housed in Indiana and is accessed by [Taxpayer's] users located outside Indiana." Elsewhere, Taxpayer further explained that iAnywhere "specializes in mobile computing, management and security and enterprise database software."

As to Taxpayer's assertion that the iAnywhere software charges should somehow be parsed between its instate and out-of-state users, the Department finds no support. This software provider bills Taxpayer on a fixed price

basis regardless of the number of users - inside Indiana or outside Indiana - who access the software. As before, the question is addressed by the Department's 2011 Information Bulletin 8.

> 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.

The Department is unable to agree that payments for access to the iAnywhere pre-written computer software is exempt from the state's sales and use tax.

3. Microsoft Software and Maintenance Agreements.

Taxpayer purchased computer software from Microsoft which was accompanied by Microsoft's "maintenance agreements." Taxpayer states the audit report does not name this particular vendor but that the audit assessed sales and use tax on these purchases.

Taxpayer disagrees with the assessments explaining that the software and maintenance services are used by Taxpayer "both within and outside Indiana." Taxpayer further explains that because the Microsoft software is "housed" outside Indiana, the software is exempt from sales and use tax. It is useful to repeat here that tax exemptions are "strictly construed" against the exemption and any exemption claim must fall "within the exact letter of the law." *RCA Corp.*, 310 N.E.2d at 97.

As to the maintenance agreements, Taxpayer states because the maintenance "is accessed through remotely hosted software [it] is not taxable as it does not meet the definition of a software maintenance agreement because the update, upgrades, fixes, etc. are not provided to the customer."

The Microsoft invoices establish that Taxpayer was paying for Microsoft software "electronically delivered" to Taxpayer's Indiana location. As such, the purchase of the pre-written software is subject to the state's use tax. As explained in the Information Bulletin:

> [P]rewritten programs (i.e., canned software) not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property, and sold or leased in the form of tangible personal property are subject to tax irrespective of the fact that the program may require some modification for a purchaser's particular computer.

As mentioned in Part E above, when a taxpayer claims that its purchase was exempt from tax, the taxpayer "must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* Taxpayer has not provided copies of the maintenance agreements and there is nothing which would establish that the agreements are anything other than the provision of "software patches, updates, or upgrades." The Department is unable to agree that Taxpayer has met its burden of establishing that the purchase of the Microsoft software was exempt. *See* IC § 6-8.1-5-1(c).

4. Zoho Software and Maintenance Agreements.

Taxpayer purchased a "single installation fee" for a suite of integrated software provided by a company called Zoho. Simultaneously, Taxpayer paid another fixed price for "Annual Maintenance." As to the price paid for the software, the issue is addressed in Sales Tax Information Bulletin 8 and is clearly subject to sales and use tax. As to the secondary charge for the maintenance portion of the purchase, the Information Bulletin states that a maintenance agreement is "a contract that obligates a person to provide a customer with future patches, updates, upgrades, or repairs of computer software." Other than two Zoho purchase invoices, Taxpayer has provided no information that would begin to establish that the maintenance portion of the agreement is anything less than an agreement to purchase "software patches, updates, or upgrades."

The Department does not agree that Taxpayer has established that payment for either the Zoho software or the associated maintenance agreement is exempt from the state's sales and use tax.

In short, Taxpayer has not met its burden under IC § 6-8.1-5-1(c) of establishing that any portion of the Department's audit assessment was wrong. As noted in Part A above:

> When a taxpayer challenges taxability in a specific instance, the taxpayer is required to provide documentation explaining and supporting its challenge. Poorly developed and non-cogent arguments are

subject to waiver. *Scopelite*, 939 N.E.2d at 1145.

FINDING

Taxpayer's protest is respectfully denied.

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An html version of this document.