DEPARTMENT OF STATE REVENUE

04-20190071R.ODR

Final Order Denying Refund: 04-20190071R
Gross Retail and Use Tax
For the Years 2013, 2014, and 2015

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 Final Order Denying Refund.

HOLDING

Indiana Retail Store Chain was not entitled to a refund of sales tax paid on the purchase of prewritten 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. Indiana Retail Store Chain 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 when the software was purchased by and delivered to its Indiana location.

ISSUE

I. Gross Retail and Use Tax - Computer Software and Software Maintenance Agreements.

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 § 6-2.5-3-2(e); IC § 6-2.5-4-17; 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); *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 App. 1974); 45 IAC 2.2-3-14(2); 45 IAC 2.2-3-16 (repealed); 45 IAC 2.2-5-3(b); 45 IAC 2.2-5-6(a); 45 IAC 2.2-5-8(a); 45 IAC 2.2-5-9(a); 45 IAC 2.2-5-10(a); Sales Tax Information Bulletin 8 (November 2011).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 denying it a refund on the purchase of computer software and software maintenance agreements claiming that the software was accessed and used by many of its employees located outside Indiana and - in some instances - housed on computer servers located outside the state.

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 within Indiana. Taxpayer submitted a claim for a refund of sales tax paid on the purchase of various items of tangible personal property including computer software. The Indiana Department of Revenue ("Department") conducted a review of Taxpayer's claim. The review resulted in granting a portion of Taxpayer's claim and also denying the remainder of 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 Final Order Denying Refund results.

I. Gross Retail and Use Tax - Computer Software and Software Maintenance Agreements.

DISCUSSION

The issue is whether Taxpayer has established that it was entitled to a refund of sales tax paid on the purchase of prewritten computer software on the ground that the software is accessed by users both inside and outside Indiana.

    A. Taxpayer's Burden in Claiming a Refund.

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). However, Indiana's use tax - not sales tax - allows an exemption for the "temporary storage" of tangible personal property delivered into Indiana but destined for use outside the state. IC § 6-2.5-3-2(e).

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

IC § 6-2.5-1-27 incorporates "prewritten computer software" in the definition of tangible personal property subject to sales/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. Software Maintenance Agreements.

Indiana law imposes sales tax on the price paid for software maintenance agreements when the agreement calls for upgrades, patches, and fixes. 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.

F. 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).

G. Taxpayer's Software Purchases.

1. Accuvant

Taxpayer purchased computer software from a vendor called Accuvant. Taxpayer explains that it purchased multiple licenses to use the Accuvant software. Because some of the licenses are "used outside of Indiana at store locations for security purposes," Taxpayer concludes that under Indiana's "use tax sourcing rules . . . software licenses on hardware outside of Indiana are not subject to Indiana use tax."

The Department's audit report addressed Taxpayer's refund request pointing out that Taxpayer had provided no information establishing the number of licenses which were used inside Indiana and the number of licenses which were used outside Indiana.

In addition, the report explains that the refund was not warranted because the Accuvant invoice indicated delivery of the software to Indiana.

At the outset, the Department points out that Taxpayer errs in its reliance on Indiana's "use tax sourcing rules . . ." because in each of transactions under review, Taxpayer remitted *sales* tax when it paid for the software.

Regardless of ownership interest, sourcing rules, or delivery location 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 Accuvant 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 Indiana's sales/use tax. Equally clear is IC § 6-2.5-13-1(d)(1) which provides that "[w]hen 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). In this case, the Department does not agree that the payments to Accuvant are exempt from Indiana's sales tax.

2. Fishnet Security

Taxpayer claimed that it purchased from Fishnet "several types of data encryption and security services" some of which were exempt from sales tax. Taxpayer seeks a refund of tax paid on the follow four items.

a. Checkpoint

Taxpayer states Checkpoint provides "retail point of sale security services to ensure customer credit card data . . . is protected." Taxpayer claims a refund on the ground that "[a] portion of this product is subscription-based software that is a hosted solution accessed by retail store[] locations."

b. RSA Authentication Managers

Taxpayer explains that this authentication software product requires "a user to input a . . . type of code or authorization to utilize a specific [computer] program."

c. Sophos

Taxpayer explains that this product is software encryption software and that since the software is "hosted" outside Indiana, Taxpayer is entitled to a refund of sales tax.

d. Websence

Taxpayer states that the software "provides web based encryption for [] store locations and is a hosted software solution."

In reviewing Taxpayer's refund request of the software purchased from Fishnet Security, the Department's audit found that Taxpayer had failed to establish the number of users of the software inside Indiana and the number of users located outside the state. In addition in each case the Department found that the software was purchased, paid for, and delivered to Taxpayer's Indiana location.

Again, the Department's relevant Information Bulletin is straightforward. "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')." *See also* IC § 6-2.5-13-1(d)(1).

3. JDA Software Inc.

Taxpayer seeks a refund of approximately $48,000 of tax paid on the purchase of this software. Taxpayer explains that "this is software maintained for [third party] . . . ." Taxpayer seeks a refund of "half of the tax related to these purchases because the [JDA] software is not housed solely on servers within Indiana."

4. RedPrairie Corporation

Taxpayer states it is entitled to a refund of tax paid on the purchase of the RedPrairie software and a service agreement. Taxpayer states the software is "not housed solely on servers within Indiana." As Taxpayer states, "This is an enterprise agreement wherein the fee for the various software components are based upon the headcount of active full-time employees." Taxpayer claims the refund because "the software is store on servers in both Indiana and Colorado [and] is accessed by all employees."

H. Conclusion

In each of the cases here, Taxpayer suggests that it is entitled to an apportioned refund of tax because the software is made use of by users inside Indiana and outside Indiana. However, Taxpayer has provided no basis for concluding that there is any basis to resort to the IC § 6-2.5-3-2(e) "temporary storage exemption" because the tax here at issue is "sales" tax and not "use" tax.

Taxpayer bought and paid an essentially fixed price allowing it access to computer software within this state. In instances in which delivery of the property occurs in Indiana and the purchaser pays *sales* tax, the temporary storage *use* tax exemption is inapplicable.

As to Taxpayer's purchase of the RedPrairie Corporation maintenance agreement, Indiana law on the issue is clear. IC § 6-2.5-4-17 imposes tax on the sale and purchase of maintenance agreements when the agreement calls for the provision of fixes, updates, or patches.

FINDING

Taxpayer's protest is respectfully denied.

June 3, 2019

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