DEPARTMENT OF STATE REVENUE

04-20211057R.MOD

Memorandum of Decision: 04-20211057R
Gross Retail and Use Tax
for the Years 2017 and 2018

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

The Department agreed in part that Music Instrument Retailer was entitled to a refund of Indiana sales tax paid on Retailer's transactions with various software vendors; Retailer was entitled to a refund of tax on transactions under which Retailer obtained software services, that occurred prior to July 1, 2018, and under which Retailer did not acquire a possessory interest in the vendors' software.

ISSUE

I. Gross Retail and Use Tax - Prewritten Computer Software and Software as an Exempt Service.

Authority: IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-4-17; 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); *State Bd. of Tax Comm'rs v. Jewell Grain Co.,* 556 N.E.2d 920 (Ind.1990); *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); *Mynsberge v. Department of State Revenue,* 716 N.E.2d 629 (Ind. Tax Ct. 1999); *Tri-States Double Cola Bottling Co. v. Department of State Revenue,* 706 N.E.2d 282 (Ind. Tax Ct. 1999); 45 IAC 2.2-3-14; 45 IAC 2.2-5-3; 45 IAC 2.2-5-6; 45 IAC 2.2-5-8; 45 IAC 2.2-5-9; 45 IAC 2.2-5-10; Sales Tax Information Bulletin 8 (July 1, 2018); Sales Tax Information Bulletin 8 (December 2016); WEBROOT, https://www.webroot.com/us/en/resources/glossary

Taxpayer argues that it is entitled to a refund of Indiana sales tax paid on transactions for the acquisition or use of prewritten computer software.

STATEMENT OF FACTS

Taxpayer is an Indiana company in the business of selling musical instruments and related electronic equipment. Taxpayer submitted a claim for a refund of approximately $54,000 dollars in sales and/or use tax Taxpayer paid on transactions with vendors for the acquisition or use of pre-written computer software.

The Indiana Department of Revenue ("Department") reviewed the request and granted a refund of sales tax paid on purchases of software completed after July 1, 2018. However, the Department did not agree that Taxpayer's purchases of prewritten software made before July 1, 2018, were exempt from tax. As a result, the Department denied approximately $36,000 of the original refund request attributable to those pre-July 1, 2018 transactions. The Department explained in a letter dated June 8, 2021.

> As of July 1, 2018, prewritten computer software sold, rented, leased, or licensed for consideration that is remotely accessed over the internet, over private or public networks, or through wireless media, is considered an electronic transfer of computer software and is not considered a retail transaction.

. . . .

> All invoices provided to support the refund requested for SaaS [software as a service], dated prior to July 1, 2018 are considered taxable. Therefore, tax is due on all invoices regarding SaaS in this review prior to July 1, 2018 and exempt after this date.

Taxpayer did not agree with the Department's decision denying a portion ($19,000) of the $36,000 amount and submitted a protest to that effect. In its protest, Taxpayer challenges the Department's decision denying the approximately $19,000. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for its protest. This Memorandum of Decision results.

I. Gross Retail and Use Tax - Prewritten Computer Software and Software as an Exempt Service.

DISCUSSION

The issue is whether Taxpayer has provided sufficient information establishing that it is entitled to a refund of sales tax paid on software purchases executed prior to July 1, 2018.

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).

A. 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).

B. Indiana's Complementary 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).

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). As to any of Taxpayer's vendor agreement to supply software maintenance or software updates, 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.

C. Presumption for and Against Imposition of the Tax.

As a general rule, all purchases of tangible personal property - including pre-written 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 sales tax exemptions are outlined in IC §§ 6-2.5-5 et seq. which are also applicable to use tax. 45 IAC 2.2-3-14(2).

In considering Taxpayer's argument that the purchase of software services is not subject to sales tax, the Department bears in mind that IC § 6-2.5-2-1 is a tax imposition statutory provision and therefore, is strictly construed against the imposition of tax. *Mynsberge v. Department of State Revenue,* 716 N.E.2d 629, 633 (Ind. Tax Ct. 1999). See also *State Bd. of Tax Comm'rs v. Jewell Grain Co.,* 556 N.E.2d 920, 921 (Ind.1990); *Tri-States Double Cola Bottling Co. v. Department of State Revenue,* 706 N.E.2d 282, 285 n. 9 (Ind. Tax Ct. 1999).

D. Taxpayer's Agreements with Software Vendors.

Taxpayer protested the audit findings concerning the following vendors and provided documentation to support its argument. In certain instances, Taxpayer provided copies of the underlying contract, written agreement, invoices, or terms of use.

1. ADP

The ADP invoices are labeled as bills for "Screening and Selection Services" which includes "products/services." The invoices each establish that ADP was charging Taxpayer seven-percent "taxes in this period." The underlying contract, written agreement, or terms of use were not provided.

2. Avalara

Publicly available information indicates the Avalara is a software vendor which specializes in providing its customers "[one] solution to calculate tax rates, prepare returns, and manage documents." Avalara specializes in software which manages its customers' sales, use, and international tax obligations.

Taxpayer states that it purchased access to "Software as a Service" ("Saas") from Avalara which under the then current application of Indiana's sales/use tax, qualified as exempt transactions.

The contract agreement between Taxpayer and Avalara, granted Taxpayer a "nonexclusive, nontransferable, worldwide right to access and use the Services . . . solely for [Taxpayer's] internal business operations." However, the contract reserved to Avalara "all other rights." Specifically, Avalara reserved to itself "an[d] own all right, title, and interest in the Services, the Avalara Technology, the Documentation, Avalara's Confidential Information, and all enhancements or improvements to, or derivative works . . . including any Intellectual Property . . . ."

As to the question of "ownership," the contract states that "Nothing in the Agreement transfer or conveys to [Taxpayer] any ownership interest in Avalara's Intellectual Property."

The contract considers completion or termination of the contract. Avalara obligated itself to "promptly destroy or overwrite Customer Data or Customer's Confidential Information or Personal Information"

Taxpayer explains that at the conclusion the Avalara agreement and because Avalara provided internet access to SaaS, "there is no software to return or destroy." Taxpayer concludes that it never had "control or ownership . . . over Avalara's software-as-a-service"

The Avalara invoices indicate that Taxpayer was charged sales tax.

3. Optiv Veracode

The Optiv invoice indicates that Taxpayer was paying for "CylancePROTECT" which, according to publicly available information is a "threat prevention solution . . . to block malware infections . . ." and is utilized on BlackBerry and similar devices. The price is based on the number of "endpoints" the customer is buying. In this case, Taxpayer paid for rights to 1,001 to 2,500 "endpoints" for a three-year term. An "endpoint" is "physically [the] end point on a network. Laptops, desktops, mobile phones, tablets, servers, and virtual environments can all be considered endpoints." WEBROOT, https://www.webroot.com/us/en/resources/glossary (Last visited January 23, 2022).

Taxpayer provided a copy of a down-stream agreement with BlackBerry which provided that an unnamed "Customer" was not permitted - under the terms of the agreement with Blackberry - to "sell, rent, lease, use for timeshare or service bureau purposes, sublicense or transfer the Blackberry Solution" The agreement between unnamed "Customer" and Blackberry stipulated that "Customer" "does not acquire any Intellectual Property Rights in or relating to the Blackberry Solution or any translation or other derivative work thereof."

4. Mitel (Converged Technology)

According to publicly available information, "Mitel" is in the business of providing phone, web, mobile, and desktop communications services. That information stipulates that "Mitel software is certified HIPAA and SOC-2 compliant." Converged Technology, which was the intermediary through whom Taxpayer acquired the Mitel software services, provides cloud and locally based "phone solutions"

Taxpayer states that Mitel provided "a license to access software-as-service remotely." According to Taxpayer, it

was not permitted to copy the software or to download the software to Taxpayer's "own computers, network, or servers."

Taxpayer further states that upon conclusion of the agreement, it would lose "all access to Mitel's software-as-a-service and that any documentation relating to the service in [Taxpayer's] possession must be destroyed.

The Converged Technologies invoices indicate that Taxpayer was paying for a one-year agreement to maintain and support Taxpayer's "Time and Material" suite of Software. That particular invoice indicates that Converged was charging Taxpayer a seven-percent "sales tax."

The second Converged invoice indicates that Taxpayer was paying for "recurring team meetings," "onsite visits," "validation of architecture," "solution audit and best practice review," assistance in "disaster recovery planning," "upgrade planning," and "building and mentoring for Customer support service." This second invoice also indicates that Converged was charging Taxpayer a seven-percent "sales tax."

The third Converged invoice states that Taxpayer was paying for "Acrobat Pro DC," "Photoshop CC Team," and "Creative Cloud All CLDs Apps."

Another Converged invoice states that Taxpayer was paying for "T&M Partner Support" accompanied by "upgrade assurance and brightmetrics."

5. DOMO

DOMO describes itself as a provider of "data integration," "business analytics," "intelligent apps," and embedded data analytics. The contract between DOMO and Taxpayer explains that DOMO is providing internet access to "Subscription Services" which is "limited, worldwide, non-exclusive, non-transferable (except as expressly permitted in [the] Agreement."

Taxpayer was permitted to "install the Software on [Taxpayer] or [its] Affiliates' computer system or other devices for [to] solely facilitate [Taxpayer's] authorized use of the Subscription Services" Taxpayer was granted the right to reproduce "a reasonable number of copies of the Documentation solely in connection with [Taxpayer's] use of the Subscription Services."

The DOMO agreement reserves to the vendor "exclusive ownership of all right, title, and interest, including all intellectual property rights, in, to and under the Subscription Services, Installed Software, and Documentation [including] all apps, cards and other add-ons to the Subscription Services" DOMO specifically reserved to itself "all modifications, updates, customizations, enhancements, improvements, and derivative works of 'Domo Technology.'" The DOMO agreement stipulates that Taxpayer - and its affiliates - were not permitted to "sell, rent, lease, or usethe Subscription Services."

Although the agreement permitted Taxpayer to make a limited number of copies, Taxpayer states that it was purchasing a subscription service accessed over the internet "so there is no software to return or destroy" which establishes that Taxpayer had "no control or ownership. . .over DOMO's software-as-a-service."

The DOMO invoices indicate that Taxpayer was paying for "Platform Access License" to a "Professional Bundle" DOMO's software along with "custom consulting" and "Premium Plus Support."

6. Jet Brains

Jet Brains describes itself as a "cutting-edge software vendor specializing in the creation of intelligent development tools. . .."

The Jet Brains invoices indicate that Taxpayer was paying for "Commercial Annual Subscriptions" and was being charged a seven percent "Tax Rate."

7. Linkedin

The underlying "Master Services Agreement," ("MSA") granted Taxpayer a "nonexclusive, royalty-free, irrevocable, worldwide, sub-licensable, transferable license to use, reproduce, modify, offer to sell, and distribute the Supplier IP in connection with its use of the Work Product. . .." The MSA specified that the certain portions of

the agreement would "by their nature extend beyond the termination of this MSA [and] survive the termination of this MSA." Under the terms of the MSA, Taxpayer was required to "return or destroy all of Supplier's Confidential Information. . .."

The Linkedin invoices indicate that Taxpayer was paying for "Recruiter - Corporate," "Job Slots," and "Dashboard Managers." Another of the invoices describe these as a "recruiter account with team collaboration," a "reserved annual job posting with ability to change, update, remove on demand," and the dashboard as a "seat to manage jobs in Linkedin. . .."

8. Qualys

The agreement between Taxpayer and Qualys states that "Qualys will make [] cloud services available to [Taxpayer] in accordance with this Agreement. . .." The agreement further specifies that "[a]ny Software provided hereunder is licensed, not sold, to [Taxpayer] on a subscription basis and only for the limited use as permitted herein. . .." At the conclusion of the subscription term, the agreement requires that the Qualys "[s]oftware must be uninstalled within 10 days of the end of the Subscription term."

Taxpayer was not permitted to "modify, adapt, alter, translate, or create derivative works of the [Qualys] Cloud Services or Documentation." Further, Taxpayer was not permitted to "reverse engineer, reverse assemble, disassemble, decompile or otherwise attempt to decipher any code used in connection with the Cloud Services and/or any aspect of Qualys' technology." Qualys labeled or "marked" its proprietary software and Taxpayer was not permitted to "remove, alter or obscure any proprietary notices on the Cloud Services or the Documentation."

The agreement contemplated - but did not require - that Qualys would provide Taxpayer certain computer hardware. However, at the conclusion of the subscription term, any hardware thus supplied "must be returned to Qualys within 10 days of the end of the subscription."

A. Analysis and Conclusions.

Software transactions which occurred prior to July 1, 2018, are governed by the Department's information bulletins which represented the Department's review and analysis at the time of the transaction.

Sales Tax Information Bulletin 8 (July 1, 2018) is clear on the relevance and application of the 2011 and 2016 Bulletins:

> [T]ransactions involving remotely accessed software occurring prior to July 1, 2018, will need to be analyzed using guidance published in the prior version of this bulletin.

As such, the vendor transactions which occurred during and after December 2016 are governed by Sales Tax Information Bulletin 8 (December 2016), 20170125 Ind. Reg. 045170026NRA. Information Bulletin 8 provides guidelines for distinguishing transactions in which a customer is purchasing taxable, pre-written software or the customer is paying for access to and use of software the customer does not own. As explained in Sales Tax Information Bulletin (December 2016):

> Charges for accessing prewritten software maintained on [a] vendor or third party's computer 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 on the server.

In deciding whether or not the buyer has acquired "an ownership interest" in the software, the 2016 Bulletin further provides:

> 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.

Based on the documentation provided, the Department agrees that transactions with Avalara, Optiv Veracode, Mitel (Converged Technology), DOMO, Qualys were not subject to Indiana's sales tax because the transactions called for the provision of software services and granted Taxpayer no possessory interest in the underlying pre-written software during or after the subscription term. The Department's conclusion as to the Mitel (Converged Technology) transactions exempts only those transactions in which Taxpayer paid for software services and not for software maintenance services.

In the absence of verifiable supporting documentation, the Department is unable agree that Taxpayer is entitled to a refund of transactions with ADP, Jet Brains, and Linkedin because the information provided is ambiguous or the nature of the transaction (what Taxpayer is buying and what the vendor is selling) is unclear.

FINDING

To the extent specified in this Memorandum of Decision, Taxpayer's protest is sustained in part and denied in part.

June 6, 2022

Posted: 04/26/2023 by Legislative Services Agency
An html version of this document.