

Memorandum of Decision: 04-20210105
Gross Retail Tax
For the Years 2017, 2018, and 2019

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 Manufacturer was entitled to a refund of sales tax paid on the purchase of computer software; Indiana Manufacturer's 2017 and 2018 software purchases were exempt because Manufacturer acquired no possessory interest in the software; the 2019 software purchase was exempt because it qualified as "software as a service" under current Indiana law.

ISSUE

I. Gross Retail Tax - Computer Software.

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 § 6-2.5-4-16.7 (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); *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](#); [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 (December 2016).

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

STATEMENT OF FACTS

Taxpayer is an Indiana manufacturer of automobile parts. Taxpayer reviewed the price it paid to a software vendor called "Plex Systems." Taxpayer paid sales tax on transactions which occurred in April 2017, April 2018, and April 2019.

Taxpayer electronically filed a "Claim for Refund," seeking a refund of approximately \$100,000 in sales tax paid on the transactions with Plex Systems. Taxpayer sought a refund of sales tax paid Plex Systems on the grounds that Taxpayer acquired exempt services from this vendor.

The Indiana Department of Revenue ("Department") reviewed the refund claim and issued a letter dated May 2021 denying the claim. The letter explained:

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 not considered a retail transaction. In other words, transactions for prewritten computer software remotely accessed from a 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, are not considered retail transactions, and therefore, the purchase, rental, lease, or license of that software is not subject to Indiana sales tax.

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 three retail transactions at issue - Taxpayer was purchasing exempt software services, that it was not purchasing "canned" computer software, and that it was not acquiring an ownership or possessory interest in the software.

A. Indiana's Sales and 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).

B. 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 the exemption here sought by Taxpayer, 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).

C. Taxpayer's Software Purchases from Plex Systems.

Taxpayer explained its position and provided documentation relevant to the three transactions. Each of the three invoices contain the same description of what it was that Taxpayer was paying for:

- Plex Education Services;
- Plex Manufacturing Cloud Services;
- Plex Manufacturing Support Services.

Taxpayer explains that Plex Systems provides a remote platform on which Taxpayer loads its own data. The software then manages, processes, manipulates, and makes available that data to Taxpayer. The Plex Systems' platform is remotely accessed by Taxpayer by means of a local internet connection. The contract explains what it is that Plex Systems provides.

Plex designs, develops, and markets a complete suite of enterprise application modules as a service which allows authorized users to login, navigate menus, view and update data, run reports, and interact the online information operated and maintained by Plex.

The contract with Plex Systems - which includes all three yearly payments - governs the relationship between Plex Systems and Taxpayer and contains the following provisions.

In consideration for the Monthly Subscription Fee . . . Plex grants to the customer an ongoing, non-transferable right to access and use the Plex Online Service and documentation.

Plex retains sole ownership of the Plex Online source code including, without limitation, any and all enhancements [and] modifications . . .

[Taxpayer] is and shall remain the sole exclusive owner of all Customer Data.

Plex shall frequently provide system-wide service upgrades to Customer as part of its Services. These . . . upgrades shall be provided at Plex' discretion and at Plex' expense.

The contract contains a provision under which the agreement can be terminated by either Plex Systems or Taxpayer. In the event of a termination, Plex Systems is required - at Taxpayer's request - to provide a copy of any Taxpayer owned data. Taxpayer is required to make that request within 100 days "from termination of this agreement."

D. The 2019 Software Transaction.

The April 2017, April 2018, and April 2019 transactions fall within two different taxing régimes. The Indiana General Assembly 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.

The April 2019 transaction comes within the ambit of IC § 6-2.5-4-16.7 and - based on the information provided - is clearly and plainly exempt. At the time the invoice was issued, and the tax was paid, Plex Systems provided Taxpayer "the right to remotely access prewritten computer software over the Internet." *Id.*

E. The 2017 and 2018 Software Transactions.

IC § 6-2.5-4-16.7 is not directly relevant to April 2017 and April 2018 purchases because these two transactions at issue each took place before July 1, 2018, and IC § 6-2.5-4-16.7 has no "look back" effect.

Instead, the April 2017 and April 2018 transactions are governed under IC § 6-2.5-1-27 simply incorporates "prewritten computer software" in the definition of tangible personal property subject to sales/use tax.

Taxpayer argues that the April 2017 and April 2018 transactions at issue are not subject to sales/use tax because it never gained a possessory interest in any of the Plex Systems' software. For purchases which took place December 2016 and before July 1, 2018, the issue Taxpayer raises is addressed in Sales Tax Information Bulletin 8 (December 2016), 20170125 Ind. Reg. 045170026NRA, available at <http://iac.in.gov/iac//20190424-IR-045190227NRA.xml.html> (last visited October 19, 2021).

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 (*Emphasis added*).

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 (December 2016) 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.

I. Analysis and Conclusions.

The "service agreement" between Plex Systems and Taxpayer defines the terms under which Taxpayer licensed the software and the taxability of the payment transactions. 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 Systems' platform, but the agreement provides that Taxpayer "remain[s] the sole and exclusive owner of all Customer Data." The Plex Systems' software modules are made accessible to

Taxpayer "through an up-to-date Microsoft Web Browser running over a standard Internet connection"

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

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

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

Under the terms of the parties' agreement, Taxpayer retained ownership of its own data managed, stored, and manipulated by the Plex Systems' software, but Plex Systems retained ownership of its own software modules which performed those functions. A review of the Sales Tax Information Bulletin 8 (December 2016) ownership "factors," establishes that this particular software agreement "ticks all the boxes."

Taxpayer made 2017 and 2018 payments for the right to access Plex Systems' software modules, but Plex Systems 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 of the software, and the April 2017 and April 2018 payments made to Plex Systems were not subject to Indiana's sales tax. Taxpayer is entitled to a refund of the 2017, 2018, and 2019 sales tax paid pursuant to the Plex Systems/Taxpayer agreement.

FINDING

Taxpayer's protest is sustained for the reasons stated above.

October 21, 2021

Posted: 12/29/2021 by Legislative Services Agency
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