DEPARTMENT OF STATE REVENUE

04-20211056R.MOD

Memorandum of Decision: 04-20211056R
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 Healthcare Provider was entitled to a refund of Indiana sales tax paid on Provider's transactions with various software vendors; Provider was entitled to a refund of tax on agreements under which Provider obtained software services, occurring prior to July 1, 2018, and under which Provider 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).

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 offering healthcare providers billing and management services. Taxpayer submitted a claim for a refund of approximately $47,000 dollars in sales and/or use tax Taxpayer paid to 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 and/or services completed after July 1, 2018. However, the Department did not agree that Taxpayer's purchases of prewritten software completed before July 1, 2018, were exempt from tax. As a result, the Department denied approximately $37,000 of the original refund request attributable to those pre-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 the remaining $37,000 amount and submitted a protest to that effect. 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 pursuant to software agreements 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 of 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 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. AppRiver

Publicly available information indicates that "AppRiver is an email and web security firm . . . [which provides] comprehensive email security and compliance to protect email, data, and users." AppRiver provides customers a "powerful spam filter" which blocks "phishing, spoofing, malware, ransomware, and zero-day threats. . .."

The AppRiver agreement calls for it to provide "services" which consisted of a "non-exclusive, non-transferable, non-assignable, non-refundable. . ..non-sublicenseable right to use the Services solely for [Taxpayer's] own internal business purposes. . .." Taxpayer was not permitted to "copy, distribute, rent, lease, transfer, or sublicense all or any portion of the Services to any part." Taxpayer was not permitted to "modify or prepare any derivative works of the Services." Nor could Taxpayer "reverse engineer, decompile, or disassemble the Services" nor "modify or remove the branding used in conjunction with the Services. . .."

The agreement calls for Taxpayer to acknowledge in writing that the "Services are the proprietary and exclusive property of [AppRiver]" and that AppRiver "retain[s] all rights, title and interest in and to all patents, copyrights, trade secrets, trademarks and other intellectual property rights in the Services." In addition, Taxpayer was required to acknowledge that it did "not acquire hereunder any right, title, or interest in the Services. . .."

Upon termination of the AppRiver agreement, Taxpayer would be denied "access to, or able to use the Services."

The AppRiver invoice provided by Taxpayer does specifically indicate that a tax is charged. However, the difference between the "current charges" and the "invoice total" is seven percent.

2. Box

Box is an out-of-state company which provides "cloud" data storage, data management, and data analytics services. In other words, Box states that it provides a "cloud-based content management platform." The Box and Taxpayer agreement specifies that Taxpayer's content uploaded to Box remains Taxpayer's property and the underlying Box content remains the property of Box. As the agreement specifies, "All contents of the Site and Services including but not limited to logo, design, text, software, technical drawings, configurations, graphics, other files, and their selection and arrangement and Box Confidential Information belong to Box, and/or its suppliers, affiliates, or licensors." In sum, the agreement specifies that "[n]o title or ownership of any proprietary rights related to the Services or Box Confidential Information is transferred to [Taxpayer] pursuant to these terms."

3. CA, Inc.

CA, Inc., according to publicly available information, "designs, markets, licenses, and supports standardized computer software products." Taxpayer's agreement with CA, Inc. stipulates that "CA retains all right, title, copyright, patent, trademark, trade secret and all other proprietary interest to all CA Offerings . . ."

Under the terms of the agreement, Taxpayer was allowed "a non-transferable and non-exclusive right for [Taxpayer] and its Authorized Users to access and use SaaS for [Taxpayer's] internal business use during the Subscription Term . . ." Taxpayer was obligated not to "provide, sublicense, or transfer the CA Software or its results/outputs other than to Authorized End Users." In addition, Taxpayer was required not to "rent, sell, lease, assign, transfer or sublicense the software . . ."

At the conclusion of the Subscription Term, CA, Inc. would "terminate all of [Taxpayer's] use rights and licenses . . . [and that Taxpayer would" delete all full or partial copies of the CA Software . . . and verify such deletion in a statement signed by a Vice-President or duly authorized representative. . ."

The CA, Inc. invoices each specify that Taxpayer is being charged a seven percent "Tax Amnt."

One of the CA, Inc. invoices indicate that Taxpayer is paying for a "subscription" made available to 175 of Taxpayer's authorized software users. This invoice, explains that the "subscription" consists of "SaaS" or "Software as a Service."

4. Zscaler (CDW Computer Centers, Inc.)

According to publicly available information, "Zscaler" is a suite of various computer software security tools. In this case, the Zscaler software was provided by CDW. That publicly available information indicates that CDW provides

its customers laptops, printers, monitors, networking equipment, and software.

The contract between CDW and Taxpayer stipulated that Taxpayer was paying for a "subscription cloud-based service" but that the Zscaler would retain all "rights and title in and to the products, Zscaler Materials, and documentation, including all intellectual property rights . . .." Taxpayer was not permitted to - or allow any third party to - "modify, copy, display, republish or create derivative works based on the Products or Zscaler Materials [or] reverse engineer the products." In addition, Taxpayer was denied "the right to access or download copies of the software to [Taxpayer's] own computers, servers, or networks. . .."

The agreement with CDW permitted Taxpayer the right to "access" the software but that right would "terminate" at the end of the "Subscription Term."

The CDW invoices each specify that Taxpayer is being charged a seven percent "sales tax."

5. Cornerstone

Cornerstone describes itself as a provider of "skill development," "virtual training," "compliance management," "content curation" and various security and personnel management services.

Taxpayer and Cornerstone entered into a "Master Agreement" under which Cornerstone became obligated to "make the Software available on a non-exclusive basis to [Taxpayer] via the Internet." Cornerstone obligated itself to provide the services but "not to access, modify, or disclose [Taxpayer] Data except as compelled by law. . .."

The Master Agreement specified that Taxpayer could "only use the Products for its own lawful, internal business" and was not permitted to "use or deploy the Software in violation of. . .this Agreement" or "resell the Products except through Extended Enterprise transactions/ registrations," "create any derivative works based upon the Products," "reverse engineer, reverse assemble, decompile or otherwise attempt derive source code from the Software," or to "make the Products available to any unauthorized parties."

The agreement calls for Taxpayer to acknowledge that "Cornerstone will and does retain all propriety and intellectual property rights, title and interest. . .in and to the Products." However, the agreement specifies that Taxpayer "retains all proprietary and intellectual property rights, title and interest in and to [Taxpayer's] Data and [Taxpayer] Content."

Upon termination of the agreement Taxpayer was required to "cease using all Products" except to retrieve Taxpayer's own data.

The Cornerstone invoices each specify that Taxpayer is being charged a seven percent "Tax Total."

6. Optiv Veracode

The Optiv Veracode invoice specifies that Taxpayer is being charged a seven percent "Estimated Tax." Taxpayer was paying for an "integration license," various "subscriptions," and a "basic kickstart program. . .."

7. Microsoft

Taxpayer's contract with Microsoft states that the "software is licensed, not sold, and [that] Microsoft reserves all rights to the software not expressly granted by Microsoft." Taxpayer was not permitted to "publish, copy, rent, lease, sell, export, import, distribute, or the Services. . .."

The contract permitted Microsoft to update the software and that Microsoft could "automatically check [Taxpayer's] version of the software and download software updates or configuration changes." Although Taxpayer was not required to update the software," Microsoft "does not charge its subscribers any additional amounts for updates."

The contract contemplates a conclusion to the parties' relationship. The contract states that "[i]f your Microsoft account is closed (whether by you or us). . ..your right to use the Microsoft account to access the Services stops immediately." In such an instance, Microsoft would "disassociate" Taxpayer's content and that Taxpayer should maintain its own backup facilities "to retrieve [Taxpayer's] Content or Data once [Taxpayer's] account is closed."

The Microsoft invoices each specify that Taxpayer is being charged a seven percent tax on such items as an

"AsureComputer ShrdSvr" but is not being charged tax on payments for "cloud services." In other words, the invoices detail the cost charged for each line item and specify that each charge is either "taxable" or "exempt."

8. Salesforce

Taxpayer entered into an agreement with Salesforce for "products and services that are ordered by [Taxpayer] under an Order Form or online purchasing portal or provided to [Taxpayer] free of charge . . ."

Under the Salesforce agreement, Taxpayer was not permitted to "make any Service or Content available to anyone other than [Taxpayer] or its Affiliates, unless expressly stated otherwise in an Order Form or the Documentation . . ." Taxpayer was not permitted to "sell, resell, license, sublicense, distribute, make available, rent or lease any Service or Content. . .." Further, Taxpayer was permitted to "copy content except as permitted herein or in an Order Form or the documentation [or to] frame any part of any Service or Content. . ." Unless permitted by law, Taxpayer was not to "disassemble, reverse engineer, or decompile a Service or Content" or access that information to "build a competitive product or service [or] copy any ideas, features, functions, or graphics. . .."

The Salesforce agreement does not specifically address the parties' obligations upon termination of the agreement. However, Taxpayer interprets the contract as follow: because Salesforce is selling a "subscription accessed via the internet. . .there is no software to return or destroy."

The Salesforce invoices each indicate a line-by-line seven percent "Tax rate."

9. Logmein

The "Terms of Service" between Logmein and Taxpayer calls for Logmein to provide various online storage "services." Although the agreement's terms allow Taxpayer to make use of the Logmein services, Taxpayer was not permitted to "modify, prepare derivative works, or reverse engineer [Logmein] services. . .." The agreement specifies that Logmein retained "all proprietary right, title and interest in the Services, [Logmein's] name, logo or other marks . . . and any related intellectual property rights including, without limitation, all modifications, enhancements, derivative works, and upgrades thereto."

The Logmein invoices indicate that Taxpayer is being a seven percent "tax total" for an "Enterprise 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. The bulletin 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.

> 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 the buyer has acquired "an ownership interest" in the software, the 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 software transactions with AppRiver, Box, CA, Inc., Zscaler (Computer Centers Inc.), Cornerstone, Microsoft, Salesforce, and Logmein 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 these specific transactions exempts only those transactions in which Taxpayer paid for software services, not for software maintenance services, and not for any hardware.

The Department is unable agree that Taxpayer is entitled to a refund of transactions with Optiv Veracode 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

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An html version of this document.