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**INFORMATION BULLETIN #8
SALES TAX
DECEMBER 2016
(Replaces Bulletin #8 dated November 2011)**

SUBJECT: Application of Sales Tax to the Sale, Lease, or Use of Computer Hardware, Computer Software, and Digital Goods

REFERENCE: IC 6-2.5-1-13; IC 6-2.5-1-14.5; IC 6-2.5-1-16.2; IC 6-2.5-1-16.3; IC 6-2.5-1-16.4; IC 6-2.5-1-21; IC 6-2.5-1-24; IC 6-2.5-1-26.5; IC 6-2.5-1-27; IC 6-2.5-2-1; IC 6-2.5-2-2; IC 6-2.5-4-1; IC 6-2.5-5-3; IC 6-2.5-5-8

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SUMMARY OF CHANGES

Aside from nonsubstantive, technical changes, this bulletin is changed to address issues such as Software as a Service, cloud computing, and various other matters related to remotely accessed software.

I. Definitions

The term “**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.

The term “**computer**” means an electronic device that accepts information in digital or similar form and manipulates it for a result based on a sequence of instructions. This includes smartphones, electronic tablets, e-readers, and any other mobile electronic device that meets this definition.

The term “**computer hardware**” includes the machinery and equipment that constitute the physical computer assembly including, but not limited to, such items as:

- Central processing units
- Keyboards
- Mice
- Video monitors
- Card or tape punchers
- Electronic message scramblers
- Data storage devices
- Processors
- Output units
- Flexowriters
- Card readers
- Paper tape input machines
- Verifiers
- Card converters
- Sorters
- Collators
- Printers
- Panels
- Terminals
- Modems

Note: The internalized instruction code that controls the basic (i.e., arithmetic and logic) operations of the computer and causes the computer to execute instructions contained in system programs is an integral part of the computer. It is not normally accessible or modifiable by the user. Such internal code systems are considered part of the computer’s hardware.

The term “**terminal**” or “**online**” **arrangement** means any arrangement whereby the lessee or purchaser of a terminal unit or units is connected by telephone lines or other methods to a computer system in such a way that the input and output operations of the terminal unit and equipment are under direct control of the computer.

The term “**computer software**” means a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task.

The software may be in the form of:

1. **System programs (except for the instruction codes, which are considered tangible personal property)** – Programs that control the hardware itself and allow it to compile, assemble, and process

application programs. The most common example would be a computer's operating system.

2. **Application programs** – Programs that are created to perform business functions or control or monitor processes.
3. **Prewritten programs (canned or commercial off-the-shelf/COTS software)** – Programs that are either system programs or application programs and are not written specifically for the user.
4. **Custom programs** – Programs created specifically for the user.

The term “**prewritten computer software**” means computer software, including prewritten upgrades, which is not designed and developed by the author or other creator to the specifications of a specific purchaser. Please note the following:

- The combining of two or more prewritten computer software programs or prewritten parts of the programs does not cause the combination to be something other than prewritten computer software.
- Prewritten computer software includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than the purchaser.
- If a person modifies or enhances computer software of which the person is not the author or creator, the person is considered to be the author or creator only of the person's modifications or enhancements.
- Prewritten computer software or a prewritten part of the software that is modified or enhanced to any degree, where the modification or enhancement is designed and developed to the specifications of a specific purchaser, remains prewritten computer software. However, where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for such a modification or enhancement, the modification or enhancement is considered a non-taxable service and not prewritten computer software.

The term “**computer software maintenance contract**” means a contract that obligates a person to provide a customer with future patches, updates, upgrades, or repairs of computer software. (For information on maintenance agreements, see [Sales Tax Information Bulletin #2](#)).

The term “**cloud computing**” is defined by the National Institute of Standards and Technology of the U.S. Department of Commerce as “a model for enabling ubiquitous, convenient, on-demand network access to a shared pool of configurable computing resources (e.g., networks, servers, storage, applications, and services) that can be rapidly provisioned and released with minimal management effort or service provider interaction.” (Available at <http://nvlpubs.nist.gov/nistpubs/Legacy/SP/nistspecialpublication800-145.pdf>).

Recently, specific terms for certain types of cloud computing products have developed: “**Software as a Service**” (“SaaS”), “**Infrastructure as a Service**” (“IaaS”), and “**Platform as a Service**” (“PaaS”). While the terminology does not appear to be uniform across the industry, the following definitions apply for the purposes of this bulletin:

- SaaS is defined as a service provider hosting software application over the internet for a customer.
- IaaS is defined as a service provider owning, maintaining, operating, and housing equipment (such as hardware, servers, network components, etc.) used to support a customer's operations, which the customer accesses via the internet in order to use the equipment.
- PaaS is defined as a service containing elements of both IaaS and SaaS.

The term “**lease**” or “**rental**” means, in general, any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration and may include future options to purchase or extend. The term “**lease**” or “**rental**” does not include:

- (1) a transfer of possession or control of property under a security agreement or deferred payment plan that requires the transfer of title upon completion of the required payments;
- (2) a transfer of possession or control of property under an agreement that requires the transfer of title upon completion of required payments and payment of an option price that does not exceed the greater of \$100 or 1% of the total required payments; or
- (3) providing tangible personal property along with an operator for a fixed or indeterminate period, if:
 - (A) the operator is necessary for the equipment to perform as designed; and
 - (B) the operator does more than maintain, inspect, or set up the tangible personal property.

The term “**batch services arrangement**” means an arrangement whereby a consumer of computer services acquires access to a computer system in a manner that is not facilitated by a direct connection. Whatever data the consumer has for input is supplied to the operator of the computer for translation to a form acceptable by the computer. In such an arrangement, access to the computer can only be accomplished by intervention of the operator.

The term “**transferred electronically**” refers to an item that is obtained by a purchaser by means other than tangible storage media.

The term “**specified digital products**” means electronically transferred (1) digital audio works; (2) digital audiovisual works; or (3) digital books.

The term “**digital audio works**” means works that result from the fixation of a series of musical, spoken, or other sounds, including ringtones.

The term “**ringtones**” means digitized sound files that: (1) are downloaded onto a device; and (2) may be used to alert the customer with respect to a communication.

The term “**digital audiovisual works**” means a series of related images that, when shown in succession, impart an impression of motion, together with accompanying sounds, if any.

The term “**digital books**” means works that are generally recognized in the ordinary and usual sense as books.

II. Computer Hardware

The sale or lease of computer hardware represents the transfer of tangible personal property and is a retail transaction subject to tax based on the total purchase price charged including, but not limited to, charges for instructional materials, installation charges, and internalized instruction codes that control the basic computer operations.

To the extent computer hardware will be used directly in direct production of another product, its purchase is exempt from tax pursuant to the manufacturing exemption found at IC 6-2.5-5-3. To support the exemption, the purchaser must show the computer has an immediate effect on the article being produced as the result of being an essential and integral part of an integrated production process. With respect to computers, this is known as computer-assisted manufacturing (CAM). By contrast, computers used for research and development or preproduction functions, known as computer-assisted design (CAD), do not qualify for the manufacturing exemption. However, such computers may qualify for the research and development exemption. The exemption for research and development equipment applies only to equipment purchased for the purpose of research and development activities. Research and development activities include any activities devoted directly to experimental or laboratory research and development for new products, new uses of existing products, or improving or testing existing products. For more information on the research and development exemption, please refer to Sales Tax Information Bulletin #75, available online at www.in.gov/dor/3650.htm.

If a computer is leased with exempt software programs where the bill is not segregated, this results in a transaction that is subject to tax on the entire charge.

Computer equipment and programs purchased or leased exempt from tax on the basis of a “resale” exemption are subject to use tax if they are put to a taxable use at any time subsequent to the exempt purchase. The subsequent sale of tangible personal property that has been leased or rented is subject to sales or use tax.

The sale or lease of computer time through the use of a terminal or as a result of a batch service arrangement is a nontaxable service and is not subject to tax if separately billed or charged. However, any charges for computer equipment (i.e., the terminal) remain subject to tax.

Note: For information on the application of Indiana sales tax to products transferred electronically, including reports and other documents compiled by a computer, please refer to Commissioner's Directive #41, available online at www.in.gov/dor/3617.htm.

III. Computer Software

a. Application of Sales Tax to the Sale, Lease, or Use of Computer Software

As a general rule, transactions involving computer software are not subject to Indiana sales or use tax provided the software is in the form of a custom program specifically designed for the purchaser.

However, prewritten programs (i.e., commercial off-the-shelf/COTS or 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. Prewritten or COTS computer programs are taxable, because the intellectual property contained in the prewritten program is no different from the intellectual property on a motion picture disc or in a textbook.

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.

Purchases of software stored in a tangible medium (on a disc or disk, a USB flash drive, etc.) are subject to sales tax.

Example #1: A software retailer who sells prepackaged programs on a disc or disk for use with home television games or other personal computer equipment is considered to be a vendor of tangible personal property and is required to collect sales tax on the sales price of such property.

Example #2: A firm develops and sells prewritten application programs that are available to any of the firm's potential customers and mailed on a CD-ROM. The sales of these programs are subject to tax.

Transactions involving software that is transferred using a "load and leave" method, where the seller or an agent of the seller transfers software from a portable storage device onto the purchaser's computer(s) at the purchaser's location, is subject to sales tax, since it is also delivered on a tangible medium.

Sales and use tax is also imposed on prewritten computer software transferred electronically, whether downloaded or remotely accessed for use in Indiana. This includes "mobile apps" downloaded to a smart phone, electronic tablet, or other mobile electronic device.

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 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.

Example #3: An Indiana resident pays an hourly rate to utilize a vendor's software resources, which are maintained on the vendor's computer servers

located outside of Indiana. The purchaser never uses, receives or has control of the software. Instead, the vendor uses the software to perform services on the Indiana resident's behalf. The transaction is not subject to sales tax.

Further, a purchaser may contract with a business in order to receive services, and as part of those services, tangible personal property in the form of software is provided. If the software provided to the customer is merely incidental to the provision of services (less than 10% of the total price of the transaction), then the service transaction may not be subject to sales tax as a unitary transaction.

Example #4: An Indiana business contracts with a service provider who will perform the business's IT functions. As part of the service, the Indiana business downloads the service provider's prewritten software onto the business's computer. However, the Indiana business does not use the software; rather, the service provider uses the software remotely in order to perform its IT services. The cost of the software is incidental (less than 10% of the total price of the transaction) to the service, so the transaction with the business customer is exempt from sales tax. The service provider, however, is subject to Indiana sales/use tax on the purchase of this software.

Example #5: An Indiana business contracts with a service provider who will perform the business's payroll obligations. As part of the service, the Indiana business accesses the service provider's prewritten software from a web browser on the business's computer via the internet. Although the Indiana business uses the software by inputting data into the software in order for the service provider to themselves use the software to perform its services, if the cost of the software is incidental (less than 10% of the total price of the transaction) to the service transaction, then the transaction is still exempt from sales tax.

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 taxpayer gains 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.

Example #6: Purchaser, an Indiana resident, purchases a new computer that enables the purchaser to access prewritten computer word processing and spreadsheet programs. These programs are maintained on a third party's computer or servers located outside of Indiana. They are accessed via a web browser from the Indiana resident's computer via the internet. The purchaser's software, including any documents created with the software, remains housed on the third party's servers or computers. Even though purchaser never receives the software in a tangible medium, the purchaser

has access to, use of, and control of the software. The sales of these pre-written programs are subject to tax.

Utilizing a website with an underlying web-based program does not necessarily constitute control or possession of the software. The underlying substance of the transaction needs to be examined.

Paying a fee to use prewritten computer software that is maintained on the vendor's or a third party's computer servers for a defined period of time constitutes a lease of the software, and is therefore subject to tax if the customer has access to and control of the software or the server when accessed electronically via the Internet.

Example #7: An Indiana resident pays an annual fee to access a suite of prewritten computer programs maintained on a third party's computer servers located outside of Indiana. The purchaser's software, including any documents created with the software, is housed on the third party's server. Even though purchaser never receives the software in a tangible medium, the purchaser has control of the software and uses the software. This transaction constitutes a lease of the software that is subject to tax.

A subscription to an online database that allows the customer to download reports, documents, and other information, is not subject to tax if the customer does not gain control of the underlying software of the database. For more information, please refer to Commissioner's Directive #41, which is available online at www.in.gov/dor/3617.htm.

Transactions for enhancements to software, such as upgrades or "in-app" purchases, are subject to sales tax if the software was subject to sales tax. If the software was free, but the customer is charged for the enhancements, the enhancements are subject to sales tax if the software would have been subject to sales tax had there been a charge.

A transaction for IaaS is not taxable if the customer is not purchasing, renting, or leasing the equipment. Two common models of IaaS are discussed in more detail in Parts V and VI below ("Remote Storage" and "Web Hosting").

In the case of PaaS, these transactions often involve the use of "software development tools" wherein a customer deploys their own applications into a virtual computing space so the customer does not have to invest in his or her own physical infrastructure. PaaS involve the provision of hardware (e.g., servers) and software (e.g., operating systems) in one product. As with SaaS, the taxability of the product depends on the nature of the software rights, as described above.

In the case of SaaS or PaaS, the burden is upon the taxpayer to establish how the software was used, the amount of access the taxpayer had, and so on, as described above.

As far as a service provider's obligations for paying sales tax, the software a service provider purchases to use on its customers' behalf is subject to sales tax. If the provider has not paid sales tax, it may owe use tax in Indiana once the software is used on behalf of customers in Indiana. However, if the service provider is reselling the software to its customers, the service provider may purchase the software exempt, but must charge its customers sales tax.

Example #8: An Indiana business hires a company to provide remote IT services. The company providing the remote IT services requires its customers to enter into a contract for those services. The contract includes provisions for software, hardware, and support services. The remote IT service provider requires remote access software to be installed on its customer's computers. The customer does not use the software except to allow the remote IT service provider access to the customer's computer. The remote access software is taxable to the remote IT service provider, not the customer, because the customer does not have possessive control of the software, nor does the customer use the software.

- A) Conversely, if customer were sold remote access software for personal use so the customer could access its computer from remote locations, that software is taxable to the customer.
- B) If in the example above, the contract includes the sale of canned computer software for which the customer gains possessive control, that software is taxable to the customer.
- C) If in the example above, the contract includes the sale of computer hardware for which ownership is transferred to the customer, that hardware is taxable to the customer.

b. Sourcing Software Sales

The purchase of software sometimes comes with licenses for multiple users. In 2007, the Indiana General Assembly repealed a limited "multiple point of use exemption" from sales tax for certain digital goods transactions, including computer software transactions that were delivered electronically. Since this provision was repealed, the general sourcing rules found in IC 6-2.5-13-1 apply as follows:

- If a taxpayer purchases multiple software licenses from a vendor for software that is **stored on the taxpayer's employee's hard drive and accessed from the hard drive:**
 - Sales tax is sourced per IC 6-2.5-13-1.
 - Use tax is sourced as follows:
 - Licenses stored on Indiana computers are subject to Indiana use tax, but a credit is permitted if sales/use tax is paid to another state when the software is used there first (IC 6-2.5-3-5).

- Licenses stored on computers outside Indiana are not subject to Indiana use tax when the users are outside Indiana, but sales tax paid is not refundable (IC 6-2.5-3-2).
- Licenses not stored on a computer are subject to Indiana use tax if the taxpayer possesses or otherwise keeps the software licenses in Indiana in the event that unused licenses are kept in Indiana (i.e., at the IT office or corporate domicile).
- If a taxpayer purchases multiple software licenses from a vendor for software that is **stored on taxpayer's server and accessed from the server**:
 - Sales tax is sourced per IC 6-2.5-13-1.
 - Use tax is sourced as follows:
 - If the server is located in Indiana, full amount for software licenses is subject to Indiana use tax, as the storage of the software in Indiana is considered a "use" of the software within the meaning of IC 6-2.5-3-1. However, a credit is permitted if sales/use tax is paid to another state (IC 6-2.5-3-5).
 - If the server is located outside Indiana, use tax is due on the portion of users in Indiana. If the taxpayer is given a license (or an allotment for permitted users) but is not the assigned license/user, that allotment of the license/user is not taxable in Indiana but does become part of the "available licenses." This is because the portion of the software accessed in Indiana is considered a "use" of the software within the meaning of IC 6-2.5-3-1. However, a credit is permitted if sales/use tax is paid to another state (IC 6-2.5-3-5).

Purchasers should retain vendor invoices and other related documents, such as purchase orders. Purchasers also should retain contemporaneous details about where software licenses will be deployed, using employee rosters or computer/IP address details that indicate the location of the software usage. If a taxpayer has users (e.g., employees, but not customers) located both in and out of Indiana, the taxable portion is the ratio of Indiana users to all users.

IV. Digital Goods

Pursuant to IC 6-2.5-2-1(a) and IC 6-2.5-2-2(a), sales tax is imposed on retail transactions made in Indiana. Included in the definition of a retail transaction is the sale or lease of specified digital products. IC 6-2.5-4-16.4(b) provides:

A person is a retail merchant making a retail transaction when the person:

- (1) electronically transfers specified digital products to an end user; and
- (2) grants to the end user the right of permanent use of the specified digital products that is not conditioned upon continued payment by the purchaser.

The term “specified digital products,” as defined by IC 6-2.5-1-26.5, IC 6-2.5-1-16.2, IC 6-2.5-1-16.3, and IC 6-2.5-1-16.4, currently includes only *digital audio works* (e.g., songs, spoken word recordings, ringtones, etc.), *digital audiovisual works* (e.g., movies), and *digital books*. Pursuant to IC 6-2.5-4-16.4(b), Indiana imposes sales and use tax only on specified digital products that are transferred electronically along with the right of permanent use that is not conditioned on continued payment by the purchaser.

Pursuant to Section 333 (“Use of Specified Digital Products”—Effective Jan. 1, 2010) of the Streamlined Sales and Use Tax Agreement (SSUTA —Effective Sept. 20, 2009), of which Indiana is a signatory, “A member state shall not include any product transferred electronically in its definition of ‘tangible personal property.’” Therefore, Indiana may not impose sales tax on a product transferred electronically by basing the product’s taxability on inclusion of the product in the definition of tangible personal property. Pursuant to the same section of the SSUTA, “ancillary services,” “computer software,” and “telecommunication services” are excluded from the term “products transferred electronically.” This means prewritten computer software transferred electronically is still taxable. However, IC 6-2.5-1-27.5(c)(8) explicitly excludes ancillary services from the definition of telecommunication services, which are taxable under IC 6-2.5-4-6 when such services are intrastate in nature. Accordingly, ancillary services are not subject to sales tax in Indiana.

V. Remote Storage

Remote storage is a form of IaaS and entails providing digital space in order to store or back-up a customer’s data and information. Consideration received for transactions in which the provider stores, hosts, and then provides the customer 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. Further, data transfer charges also are not subject to sales and use tax. However, if the server is a dedicated server, then that would be considered renting or leasing hardware since it is a transaction for equipment and not capacity, in which case the transaction would be subject to sales or use tax.

VI. Web Hosting & Design

Web hosting is a form of IaaS and is considered a service, and therefore not subject to sales or use tax. Further, web design is a service not subject to sales and use tax as long as tangible personal property is not transferred as part of the transaction.

VII. Web Training

Training services are not taxable. If training materials, such as books, videos, or discs, are furnished with training services beyond a *de minimis* amount, the service provider must charge sales tax on the transaction for the materials. Otherwise, the service provider must pay use tax on the costs of the *de minimis* materials transferred as part of the service transaction.

For more information on the application of Indiana sales tax to computer hardware, software, or digital goods, please contact the Indiana Department of Revenue, Tax Policy Division, at 317-232-7282.



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