

This letter discusses computer software. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

November 16, 2021

NAME/ADDRESS

RE: BUSINESS

Dear NAME,

This letter is in response to your letter received September 20, 2021, in which you requested information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

On behalf of our client, BUSINESS. (FEIN: XX-XXXXXXX), hereinafter referred to as "Taxpayer", we respectfully request the issuance of a private letter ruling ("PLR") by the Illinois Department of Revenue ("Department") pursuant to 2 Ill Adm. Code 1200.110. The current facts are very similar to those reviewed by the Department prior to issuing the Taxpayer's DATE PLR (copy enclosed). Since the previous letter ruling, some of the agreements were slightly modified, however, even with those minor changes we believe the agreements meet the necessary requirements to be exempt from tax. Due to the minor changes in the agreements and the fact that the 1999 PLR was revoked a number of years ago under 86 Ill. Admin. Code 1200.110(e). Taxpayer is looking to secure a new ruling.

FACTS

1. This Private Letter Ruling ("PLR") is not requested with regard to hypothetical or alternative proposed transactions.

2. The Taxpayer is not currently engaged in litigation with the Department in regard to this or any other tax matter.
3. The Taxpayer is not currently under audit by the Department in regard to this matter.
4. The Taxpayer requests that certain information be redacted from the PLR prior to dissemination to others. The Taxpayer requests that its name, all contractual parties' names, its exhibits, and the name of its representative be redacted.
5. The Taxpayer knows of no authority contrary to the authorities referred to and cited below.
6. To the best of the knowledge of both Taxpayer and Taxpayer's representative, the Department has not previously ruled on the same or a similar issue for the taxpayer or a predecessor within the past 10 years, nor has any representatives previously submitted the same or a similar issue to the Department but withdrew it before a letter ruling was issued.

AUTHORITY

Taxpayer believes that the software it sells under the two attached licenses qualifies for an exemption from the Retailers' Occupation Tax under the provisions of 86 Illinois Administrative Code Section 130.1935 and the attached PLR dated February 24, 1999. The representations in that ruling and the license provisions referenced remain the same.

RULING REQUESTED

Taxpayer requests that Department rule that its licenses provided are not subject to Illinois Retailer's Occupation Tax and Use Tax.

FACTS

We have included the two different types of license agreements that Taxpayer uses for its customers:

1. Perpetual software license
2. Term software license

Perpetual software license

The perpetual software license contract is made up of three documents: Software License Schedule (1A), General Terms and Conditions (1B), and Maintenance Plan (1C).

The Software License Schedule is the document that is signed by both parties. Section 5 of the Software License Schedule links to and incorporates by reference the General Terms and Conditions that apply to the license. These General Terms and Conditions are online and are not separately executed because they are incorporated into the License Schedule. Likewise, in Section 6 of the Software License Schedule, links to and incorporate by reference the Maintenance Plan that applies to the perpetual license. The Maintenance Plan is online and is not separately executed because it is incorporated into the License Schedule.

We believe the requirements of a license of software to not be a taxable retail sale under Section 130.1935 are met as follows:

1. 1A – bottom of page 3, signature line meets the requirement of Section 130.1935(1)(A).
2. 1B – Paragraphs 4, 5, and 6 restricts the customer's duplication and use of the software to meet the requirements of Section 130.1935(1)(B).
3. 1B - Paragraphs 3, 4, and 10 discusses prohibiting the customer from licensing, sublicensing or transferring the software to a third party without permission and continued control of the licensor to meet the requirements of Section 130.1935(1)(C).
4. 1B - Paragraph 4.3 discusses the permitting the licensee to make and keep an archival copy to meet the requirement of Section 130.1935(1)(D).
5. 1B - Paragraph 5.2 discusses the requirement that the customer must destroy or return all copies of the software to the licensor at the end of the license period in order to meet the requirement of Section 130.1935(1)(E).

Term software license

The term software license is set up in a similar fashion to the perpetual software license, but it contains only two documents: Software License Schedule (2A) and the General Terms and Conditions (2B).

The Software License Schedule is the document that is signed by both parties. Section 6 of the Software License Schedule links to and incorporates by reference the General Terms and Conditions that apply to the license. These General Terms and Conditions are online and are not

separately executed because they are incorporated into the License Schedule. Since maintenance fees are included in the annual license fee for the term license model, there is no separate Maintenance Plan for the term license. Rather, the maintenance services are described within the General Terms and Conditions.

We believe the requirements of a license of software to not be a taxable retail sale under Section 130.1935 are met as follows:

6. 2A – bottom of page 3, signature line meets the requirement of Section 130.1935(1)(A).
7. 2B – Paragraphs 4, 5, and 6 restricts the customer's duplication and use of the software to meet the requirements of Section 130.1935(1)(B).
8. 2B - Paragraphs 3, 4, and 11 discusses prohibiting the customer from licensing, sublicensing or transferring the software to a third party without permission and continued control of the licensor to meet the requirements of Section 130.1935(1)(C).
9. 2B - Paragraph 4.3 discusses permitting the licensee to make and keep an archival copy to meet the requirement of Section 130.1935(1)(D).
10. 2B - Paragraph 5.2 discusses the requirement that the customer must destroy or return all copies of the software to the licensor at the end of the license period in order to meet the requirement of Section 130.1935(1)(E).

We respectfully request a private letter ruling from the Department regarding this matter. Should you disagree with this opinion, please contact me to discuss this opinion prior to issuing a ruling. If you have any further questions or require any additional information, please contact me at PHONE #.

DEPARTMENT'S RESPONSE:

The Department's regulation "Public Information, Rulemaking and Organization" provides that "[w]hether to issue a private letter ruling in response to a letter ruling request is within the discretion of the Department. The Department will respond to all requests for private letter rulings either by issuance of a ruling or by a letter explaining that the request for ruling will not be honored." 2 Ill. Adm. Code 1200.110(a)(4). Further, the Department's regulations regarding Private Letter Rulings provide that "[i]f there is case law or there are regulations dispositive of the subject to the request, the

Department will decline to issue a letter ruling on the subject." 86 Ill. Adm. Code 1200.110(a)(3)(D).

A number of years ago, the Department determined that it would no longer issue Private Letter Rulings regarding whether a specific license of prewritten (canned) computer software meets the requirements of subsection (a)(1) of 86 Ill. Adm. Code 130.1935. It is the Department's position that its regulation at 86 Ill. Adm. Code 130.1935 is sufficiently clear for a licensee or licensor to determine whether a specific license of prewritten computer software meets the requirements of subsection (a)(1).

"'Computer software' means a set of statements, data, or instructions to be used directly or indirectly in a computer in order to bring about a certain result in any form in which those statements, data, or instructions may be embodied, transmitted, or fixed, by any method now known or hereafter developed, regardless of whether the statements, data, or instructions are capable of being perceived by or communicated to humans, and includes prewritten or canned software." 35 ILCS 120/2-25. Generally, sales of "canned" computer software are taxable retail sales in Illinois. Canned computer software is considered to be tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means, or other media. 86 Ill. Adm. Code 130.1935. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See 86 Ill. Adm. Code 130.1935(c)(3). Computer software that is not custom software is considered to be canned computer software.

If transactions for the licensing of computer software meet all of the criteria provided in subsection (a)(1) of Section 130.1935, neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
- D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the

licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and

- E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

If a license of canned computer software does not meet all the criteria the software is taxable.

In order to comply with the requirements as set out in Section 130.1935(a)(1), there must be a written "signed" agreement. A license agreement in which the customer electronically accepts the terms by clicking "I agree" does not comply with the requirement of a written agreement signed by the licensor and customer. The Department previously held that an electronic signature did not comply with the requirement of Section 130.1935(a)(1)(A) that the license be evidenced by a written agreement signed by the licensor and the customer. ST 06-0005-PLR (December 16, 2006). In ST 18-0003-PLR (February 8, 2018), the Department decided that an electronic license agreement in which the customer accepts the license by means of a signature in electronic form that is attached to or is part of the license, is verifiable, and can be authenticated will comply with the requirement of a written agreement signed by the licensor and customer. See ST 18-0010-PLR (September 26, 2018) for examples of acceptable written signatures. A license agreement in which the customer electronically accepts the terms by clicking "I agree" remains unacceptable.

Computer software is defined broadly in the Retailers' Occupation Tax Act. However, computer software provided through a cloud-based delivery system – a system in which computer software is never downloaded onto a client's computer and is only accessed remotely – is not subject to tax. If a provider of a service provides to the subscriber an API, applet, desktop agent, or a remote access agent to enable the subscriber to access the provider's network and services, the subscriber is receiving computer software. Although there may not be a separate charge to the subscriber for the computer software, it is nonetheless subject to tax, unless the transfer qualifies as a non-taxable license of computer software. Illinois generally does not tax subscriptions.

I would note that since your private letter ruling was issued in February 1999, the requirement in paragraph (D) of the Section 130.1935(a)(1) has been expanded to provide an additional policy option. In addition to the licensor having a policy of providing another copy at minimal or no charge if the customer loses or damages the software, a licensor that has a policy of permitting the licensee to make and keep an archival copy will also qualify under paragraph (D).

I hope this information is helpful. If you have further questions related to the Illinois sales tax laws, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Richard S. Wolters
Associate Counsel

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