

This letter discusses computer software and digital information. See 86 Ill. Adm. Code 130.1935 and 86 Ill. Adm. Code 130.2105. (This is a GIL).

February 07, 2023

NAME
COMPANY
ADDRESS1

Via E-mail: ADDRESS2

Dear Ms. XXX:

This letter is in response to your letter dated July 13, 2022, 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:

I am writing with a formal request for a General Information letter ruling on behalf of my client ("Client"), who wishes to remain anonymous at this time. In accordance with 2 Illinois Administrative Code 1200.120, we furnish the following information:

(A) Statement of Relevant Facts

Client is a nonprofit organization organized under I.R.C. §501 (c)(3), domiciled in a state other than Illinois. In its home state, Client is a registered exempt organization, exempt from both sales and use taxes as well as income taxes. Client has no employees, offices, warehouses, representatives, or inventory in Illinois. In other words, Client has no physical presence in the state.

Client specializes in the creation and administration of learning tools and professional licensing assessments. Client sells assessments, digital and print textbooks and other exam preparation materials directly to students and examinees in the majority of its sales transactions. Client also sells assessments directly to educational institutions, all of which are registered as non-profit organizations. There are limited to no sales of physical products, whether to students, examinees, or educational institutions. All assessments and examinations are distributed digitally; virtually all textbooks and preparation materials are produced digitally as well, through [sic] a limited quantity of in-print preparation materials are available. Assessments are administered in proctored examination environments (by a third-party organization), yet at the time a test taker signs up for the assessment the exact location at which the exam will be administered is not known. Test takers will be assigned to an exam site some months after purchasing the exam, and may change their designated test center on more than one occasion before sitting for the exam.

Illinois specifically exempts sales made to nonprofit organizations from sales tax under 35 ILCS 105/3-5; 35 ILCS 120/2-5, 100-260; 35 LCS 110/2; 35 ILCS 115/2; 86 Ill. Adm. Code 130.120(h); 86 Ill. Adm. Code 130.201(a)(3); 86 Ill. Adm. Code 130.501(b)(2); 86 Ill. Adm. Code 150.325; 86 Ill. Adm. Code 140.125(h)(1); 86 Ill. Adm. Code 140.201(e)(3); 86 Ill. Adm. Code 160.110(e). Yet Illinois does not necessarily exempt sales made by a nonprofit organization, but for under limited circumstances. 35 ILCS 120/1. Client thus seeks to confirm that it nonetheless qualifies for the available exemptions from sales tax, either categorically as a seller, based on the entities and individuals to which it makes sales, or based on the products and services it sells.

These products and services include:

- (1) Subject Examinations: Web-based, standardized examinations delivered digitally over the Internet, sold primarily to post-secondary educational institutions for use in accredited courses of study.
- (2) Customized Assessment Services: Web-based, instructor-tailored examinations delivered digitally over the Internet, sold primarily to post-secondary educational institutions for use in accredited courses of study.
- (3) Self-Assessment Services: Web-based, standardized benchmarking examinations delivered digitally over the Internet, sold directly to students preparing for licensure, as well as to post-secondary educational institutions in the form of vouchers for such services that are then distributed to students to be redeemed.

- (4) Comparative Examinations: Computer-based, standardized examinations delivered at third-party testing centers, primarily sold to post-secondary educational institutions and foreign students.
- (5) Licensing Examinations: Computer-based, standardized examinations delivered at third-party testing centers, sold to qualified individual applicants seeking U.S. professional licensure in their field. The licensing examinations are multi-part, and at least one of the installments of the examination must be taken and passed as a condition of graduation from the post-secondary educational institution at which the test-taker is enrolled.
- (6) Post-Licensure Examinations: Computer-based, standardized examinations delivered at third-party testing centers, sold to current and previously licensed examinees.
- (7) Specialty Certification Examinations: Web- and computer-based examinations delivered at third-party testing centers, sold to organizations for administration to licensed examinees.

(B) Statements Relating to Request

The issue for which Client requests a general information letter ruling is not under consideration by the Illinois Department of Revenue in connection with an audit examination of any type, nor is it connected with any refund request, voluntary disclosure agreement, administrative hearing, or litigation. To our knowledge, a request on the same or a similar issue has not been submitted to the taxing jurisdiction of Illinois.

(C) Statement of Requested Private Letter Ruling [sic]

Question 1: Are sales of digital assessment and professional licensing examinations and study materials made by a non-profit organization registered under I.R.C. 501 (c)(3) exempt from sales tax in Washington [sic] when sold either to educational institutions or to students enrolled in those educational institutions?

Analysis: Client is a nonprofit organization organized under I.R.C. §501(c)(3); organizations defined therein are "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes [...]" Client makes sales to educational institutions and professional associations, as well as students enrolled in accredited courses of study. The educational institutions and professional associations to which it makes sales are "educational institutions" as

defined by 35 ILCS 105/2c. Its sales of examinations, assessments, and self-assessments are professional services critical to enable these institutions and individuals to provide accredited and credentialed courses of study, and to ensure individuals can secure statutory-mandated [sic] professional licensing.

In Illinois, sales of tangible personal property to a business organization or institution organized and operated exclusively for charitable, religious, or educational purposes is exempt from retailers' occupation (sales) tax (ROT) and use tax (UT) and a sale or transfer of tangible personal property as an incident to the rendering of service for or by such an entity is exempt from service occupation tax (SOT) and service use tax (SUT). 35 ILCS 105/3-5; 35 ILCS 120/2-5, 100-260; 35 ILCS 110/2; 35 ILCS 115/2; 86 Ill. Adm. Code 130.120(h); 86 Ill. Adm. Code 130.201(a)(3); 86 Ill. Adm. Code 130.501(b)(2); 86 Ill. Adm. Code 150.325; 86 Ill. Adm. Code 140.125(h)(1); 86 Ill. Adm. Code 140.201(e)(3); 86 Ill. Adm. Code 160.110(e).

Ruling: Sales made by the Taxpayer of digital assessment and licensing materials to post-secondary educational institutions, to professional associations that govern professional licensing requirements, and individual students and/or examinees, are exempt from Illinois sales and use tax.

Question 2: Are sales of digital assessment and professional licensing examinations and study materials considered tangible personal property?

Analysis: As described above, Client makes sales of subject matter examinations, custom assessments, comparative examinations, professional licensing examinations, and other professional credentialing examinations, all of which are administered digitally at proctored test location [sic] operated by a third party.

Client also makes sales of self-assessment study materials, all of which are digital. The self-assessment study materials are designed to simulate the examination or assessment that the test taker is preparing for, consisting of practice multiple choice examination questions. The self-assessments can either occur in a simulated proctored environment, to mimic the testing conditions of the final examination or assessment. Alternatively, they can be self-paced. As they are exclusively digital, the examinations, assessments, and self-assessments are not tangible personal products.

Professional or personal services that are transmitted electronically are not tangible personal property. The assessments, examinations, and self-assessment materials more closely fall within the concept of professional or personal services transmitted in digital format. They are services that primarily involve the application of human effort by the provider (education services) to administer, grade, and evaluate the results of the assessments and examinations, allowing the test taker to pass an accredited or credentialed course of study, or to secure statutorily-mandated professional licensing. The provision of professional services that do not include the transfer of tangible personal property with the service does not result in Service Occupation Tax or Use Tax.

Illinois has consistently held that information or data downloaded electronically does not constitute the taxable transfer of tangible personal property. Ill. Admin. Code Section 130.2105.

Ruling: Sales made by the Taxpayer of digital assessment and licensing materials to individual students and/or examinees, to post-secondary educational institutions, and to professional associations that govern professional licensing requirements are not considered taxable digital good [sic] or digital automated services, but rather non-taxable personal and professional services.

(D) Statement of Contrary Authorities

Client reviewed the Illinois Tax Code and the rules of the Illinois Department of Revenue but was unable to locate a definitive contrary authority on this issue.

DEPARTMENT'S RESPONSE:

Due to the complexity of your client's enterprise and the necessity for very specific facts, your questions cannot be addressed in the context of a General Information Letter. However, this letter will provide you with basic guidelines that may be used to determine whether your client engages in taxable transactions under Illinois law.

I. Retailers' Occupation Tax

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. 35 ILCS 120/2; 86 Ill. Adm. Code 130.101. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. 35 ILCS 105/3; 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois. If the

purchases occur in Illinois, the purchasers must pay the Use Tax to the retailer at the time of purchase. 35 ILCS 105/3-45; 86 Ill. Adm. Code 150.401. The retailers are then allowed to retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales. 86 Ill. Adm. Code 150.130(b). If the purchases occur outside Illinois, purchasers must self-assess their Use Tax liability and remit it directly to the Department. See 35 ILCS 105/3-45; 86 Ill. Adm. Code 150.701(a).

II. Service Occupation Tax

Retailers' Occupation Tax and Use Tax do not apply to sales of service. Under the Service Occupation Tax Act, businesses providing services (*i.e.*, servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See 86 Ill. Adm. Code 140.101. The transfer of tangible personal property to service customers may result in either Service Occupation Tax liability or Use Tax liability for servicemen, depending upon which tax base they choose to calculate their liability.

Servicemen may calculate their tax base in one of four ways: (1) separately-stated selling price of tangible personal property transferred incident to service; (2) 50% of the serviceman's entire bill; (3) Service Occupation Tax on the serviceman's cost price if the serviceman is a registered de minimis serviceman; or (4) Use Tax on the serviceman's cost price if the serviceman is de minimis and is not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. See 86 Ill. Adm. Code Sections 140.106; 140.108; and 140.109.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of sales of service. They are required to collect the corresponding Service Use Tax from their customers. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). This class of registered de minimis servicemen is authorized to pay Service Occupation Tax

(which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit tax to the Department by filing returns and do not pay tax to their suppliers. They provide suppliers with Certificates of Resale for the tangible personal property transferred to service customers. See 86 Ill. Adm. Code 140.109.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of sales of service is less than 35% of the servicemen's annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess, and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See 86 Ill. Adm. Code 140.108.

If an entity provides services that are accompanied with the transfer of tangible personal property, including computer software, such service transactions are generally subject to tax liability under one of the four methods set forth above. If a transaction does not involve the transfer of any tangible personal property to the customer, then it generally would not be subject to Retailers' Occupation Tax, Use Tax, Service Occupation Tax, or Service Use Tax.

III. Not-for-profit service enterprises engaged in selling tangible personal property at retail.

A person whose activities are organized and conducted primarily as a not-for-profit service enterprise, and who engages in selling tangible personal property at retail (whether to the public or merely to members and their guests) is engaged in the business of selling tangible personal property at retail with respect to such transactions, excepting only a person organized and operated exclusively for charitable, religious or educational purposes either (1), to the extent of sales by such person to its members, students, patients or inmates of tangible personal property to be used primarily for the purposes of such person, or (2), to the extent of sales by such person of tangible personal property which is not sold or offered for sale by persons organized for profit. The selling of school books and school supplies by schools at retail to students is not "primarily for the purposes of" the school which does such selling. 35 ILCS 120/1; 86 Ill. Adm. Code 130.2105(a)(4)-(5); see eg. *Follett's Ill. Book & Supply Store Inc. v. Isaacs*, 27 Ill. 2d. 600 (1963).

IV. Computer software and digital data or information.

Information or data that is downloaded electronically, such as downloaded books, musical recordings, newspapers or magazines, does not constitute the transfer of tangible personal property. These types of transactions represent the transfer of intangibles and are thus not subject to Retailers' Occupation and Use Tax. However, downloads of canned software, as defined more fully in 86 Ill. Adm. Code 130.1935, are subject to Retailers' Occupation and Use Tax. 86 Ill. Adm. Code 130.2105(a)(3).

"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. Computer software includes all types of software including operational, applicational, utilities, compilers, templates, shells and all other forms. 86 Ill. Adm. Code 130.1935(a).

Generally, sales or transfers of "canned" computer software intended for general or repeated use are taxable retail sales in Illinois. Canned 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. The sale or transfer by a retailer of computer software which is subject to manufacturer licenses restricting the use or reproduction of the software is also taxable. 86 Ill. Adm. Code 130.1935(a). However, if all of the criteria provided in subsection (a)(1) of Section 130.1935 are met, then neither the sale or transfer of the software nor the subsequent software updates are subject to Retailers' Occupation Tax. Specifically, 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.

86 Ill. Adm. Code 130.1935(a)(1). If a license of canned computer software does not meet all the criteria, the software is taxable.

Please note that it is very common for software to be licensed over the internet and the customer to check a box that states that he or she accepts the license terms. Acceptance in this manner does not constitute a written agreement signed by the licensor and the customer for purposes of subsection (a)(1)(A) of Section 130.1935. To meet the signature requirement for an exempt software license, the agreement must contain the written signature of the licensor and customer.

A provider of software as a service is acting as a serviceman. As a serviceman, the seller does not incur Retailers' Occupation Tax. Service Occupation Tax is imposed upon all persons engaged in the business of making sales of service on all tangible personal property transferred incident to a sale of service, including computer software (35 ILCS 115/3), and is calculated as explained above.

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.

If an Illinois customer downloads computer software for free from an out-of-state retailer's web site or server that is also located out of state, the retailer, even though it is donating tangible personal property to the customer, has exercised no power or control over the property in Illinois. In this instance, the donor would not have made any taxable use of the property in Illinois. The customer, the donee, would incur no Use Tax liability for the retailer to collect and remit to Illinois. Illinois does not tax subscriptions.

Moreover, sales of custom computer programs prepared to the special order of the customer may not be a taxable sale. 86 Ill. Adm. Code 130.1935(c)(1). Custom software means the software which results from real and substantial changes to the operational coding of canned or pre-written software in order to meet the specific individualized requirements of the purchaser for his limited or particular use. 86 Ill. Adm. Code 130.1935(c)(2). Custom computer software is not subject to the Retailers'

Occupation Tax, Use Tax, Service Occupation Tax or Service Use Tax if the following elements are present:

- A) Preparation or selection of the program for the customer's use requires an analysis of the customer's requirements by the vendor; and
- B) The program requires adaptation by the vendor to be used in a specific work environment, e.g., a particular make and model of a computer using a specified input or output device. 86 Ill. Adm. Code 130.1935(c)(1).

If modified software is held for general or repeated sale or lease, it is canned software. 86 Ill. Adm. Code 130.1935(c)(2). 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. 86 Ill. Adm. Code 130.1935(c)(3). Computer software that is not custom software is considered to be canned computer software. See 86 Ill. Adm. Code 130.1935.

V. Remote Retailers

"Remote retailer" means a retailer that does not maintain within this State, directly or by a subsidiary, an office, distribution house, sales house, warehouse or other place of business, or any agent or other representative operating within this State under the authority of the retailer or its subsidiary, irrespective of whether such place of business or agent is located here permanently or temporarily or whether such retailer or subsidiary is licensed to do business in this State. 35 ILCS 120/1; 86 Ill. Adm. Code 131.105.

Beginning on January 1, 2021, a remote retailer is engaged in the occupation of selling at retail in Illinois, if:

- 1) the cumulative gross receipts from sales of tangible personal property to purchasers in Illinois are \$100,000 or more; or
- 2) the retailer enters into 200 or more separate transactions for the sale of tangible personal property to purchasers in Illinois.

Remote retailers that meet or exceed the threshold in either paragraph (1) or (2) above are liable for all applicable State and locally imposed retailers' occupation taxes administered by the Department on all retail sales to Illinois purchasers. 35 ILCS 120/2(b); 86 Ill. Adm. Code 131.115(a). A remote retailer must apply the provisions in Section 131.120 in determining whether a transaction should be included or excluded for purposes of determining if the remote retailer meets either of the thresholds establishing tax remittance obligations. 86 Ill. Adm. Code 131.120; 35 ILCS 120/2(b-5).

Remote retailers are deemed to be engaged in the business of selling at the Illinois location to which the tangible personal property is shipped or delivered or at which possession is taken by the purchaser. State and local retailers' occupation taxes are incurred at the rate in effect at this location. 86 Ill. Adm. Code 131.110(b).

Remote retailers are often multichannel retailers. That is, they may also sell their products through a marketplace and so are considered marketplace sellers. Marketplace facilitators required to register with the Department, as provided in Section 131.135, incur State and local retailers' occupation taxes on sales made to Illinois purchasers on behalf of remote retailers making sales over the marketplace. Remote retailers do not incur tax on these sales. 86 Ill. Adm. Code 131.110(d).

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Katarzyna Kowalska
Associate Counsel

KK:rkn