

ST 25-0028-GIL 04/15/2025 COMPUTER SOFTWARE

If updates of canned software included in a maintenance agreement consist solely of software distributed under open-source license provisions at no charge, then, even if the software is not separately itemized on the invoice, no Retailers' Occupation Tax or Use Tax is owed because the taxable base is zero. (86 Ill. Adm. Code 130.1935(b). (This is a GIL).

April 15, 2025

NAME
COMPANY
ADDRESS
EMAIL

Dear NAME:

This letter is in response to your letter dated January 23, 2025, 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 <https://tax.illinois.gov/> to review regulations, letter rulings and other types of information relevant to your inquiry.

In your letter you have stated and made inquiry as follows:

I am writing to request a private letter ruling (PLR) from the Illinois Department of Revenue (IDOR) under Illinois tax law regarding the application of Sales and Use Tax to fees for maintenance services on open-source software.

We seek this ruling to ensure that we are following compliance with Illinois tax laws and to clarify the correct tax treatment of the described activities. We believe the requested ruling is necessary due to the complexities or ambiguities involved in the application of Illinois tax law to our situation.

Below, I have provided all the required information as outlined in your guidelines for submitting a request for a private letter ruling.

Statement of Facts and Other Pertinent Information
Interested Parties:

The parties involved in this request are as follows:

- **COMPANY:** COMPANY (COMPANY) is a STATE limited liability company with an office location at ADDRESS. It is primarily engaged in the publishing of online coupons and discount offers on its website located at WEBSITE.
- **COMPANY1:** COMPANY1 (COMPANY1) is a STATE limited liability company with an office address of ADDRESS1. As shown on their website, COMPANY1 is an open source database software support and consulting services company that helps make databases and applications run better.

Description of the Transaction:

In January 20XX, COMPANY engaged COMPANY1 to perform software maintenance services such as project consulting, performance monitoring, technical support, bug fixes, software updates, and database architecture. As noted in section 5 of the MSA, COMPANY1 provides services solely with the respect of open-source software. All related software noted in the SOW is and always has been free of charge and available on public repository. This includes PostgreSQL, MySQL, MongoDB, and COMPANY1 Monitoring and Management. Since the software is free of charge, COMPANY has never purchased software from COMPANY1, only maintenance and support services.

With that engagement, a Statement of Work was made effective to perform these services. After the duration of the initial Statement of Work expired, COMPANY entered into another Statement of Work for the same services in November of 20XX. Upon expiration of that Statement of Work period, a new Statement of Work was agreed to again for the same services in November 20XX. Upon viewing the invoice for this statement of work, COMPANY1 charged COMPANY a 6.25% tax on the service fees. This was the first invoice that COMPANY1 had sent to COMPANY which included this tax. Upon inquiring about this, COMPANY1 responded and said this tax was for the application of Illinois Sales and Use tax since they registered to collect this tax in 20XX.

According to section 11 of the MSA between COMPANY and COMPANY1, the Customer agrees to pay any and all taxes arising from the agreement. That said, COMPANY questioned COMPANY1's stance that the tax is appropriately being applied. COMPANY1 responded with their reasoning (detailed below under 'Authorities Contrary to Taxpayers View'), but also suggested we submit for a private letter ruling on whether the tax should be applied. A private letter ruling was also suggested by a representative from the IDOR Taxpayer Assistance Support Team.

Analysis of Material Facts to the Issues:

Database software, patches, and updates are being provided by COMPANY1 through their maintenance and support services. However, this software is all open-source, meaning it is free of charge and found on public repository. This is clearly stated in the MSA and SOW. Thus, no tangible value is being added and the service fees are solely for the maintenance and support services on the software.

Relevant Contracts, Licenses, Agreements, or Other Documents:

Attached are the following documents that are pertinent to this request:

- **COMPANY1 Master Services Agreement:** This is the Master Services Agreement (MSA) between COMPANY and COMPANY1 made effective January 29th, 20XX. The Statement of Work attached to this agreement does not represent the fees in question.
- **COMPANY1 Statement of Work:** This is the Statement of Work (SOW) showing the services fees in question made effective on November 6th, 20XX.
- **COMPANY1 Invoice:** This is the invoice COMPANY1 sent to COMPANY dated October 29th, 20XX showing the total services fees and tax charged (6.25% of total fee).

Tax Period at Issue and Pending Audit or Litigation

This request pertains to the following tax period(s):

- **Tax Period:** The Statement of Work service period takes place from November 5th 20XX to February 5th, 20XX. The service fees were invoiced on October 29th, 20XX.

- **Audit or Litigation Status:** To the best of our knowledge, there is no pending audit or litigation related to this issue for the specified tax period.

Prior Rulings on the Same or Similar Issue

To the best of our knowledge, COMPANY has not previously submitted the same or similar issue to the Illinois Department of Revenue. Additionally, the Department has not issued any ruling on this issue for COMPANY1 or any predecessor.

Authorities Supporting the Taxpayer's View

We believe that the Illinois tax laws, regulations, and administrative rulings support the following conclusion:

Authority 1: According to 86 Ill. Adm. Code 140.301, "As part of a retail sale, charges for maintenance agreements or warranty contracts are taxable if they are included in the selling price of the tangible personal property but are not taxable if they are sold separately.

The seller of maintenance agreements and warranty contracts does incur use tax liability on the seller's cost price of any tangible personal property transferred incident to the maintenance agreement."

Per 86 Ill. Adm. Code Part 140, "Illinois does not tax sales of service."

Since the property pertaining to the agreement is strictly open-source software and free of charge, no tangible personal property is being transferred incident to the maintenance agreement. The only value added is a sale of service, which is not taxable.

Authority 2: While there are factual differences to the circumstances involving our ruling, the General Information Letter, ST 24-0017-GIL 04/04/2024 COMPUTER SOFTWARE, speaks to open-source software by stating the following, "A fee charged by a company for the services in the form of a subscription that provides customers with support, access to the software, software maintenance in the form of security updates, fixes, functionality enhancements, upgrades to the software, access to services such as its support knowledge base, product usage documentation, and account management tools is not subject to Retailers' Occupation Tax or

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Service Occupation Tax, as long as any additional software provided pursuant to the subscription is distributed under open source license provisions and is provided at no charge."

We conclude that, based on these authorities, the fees charged to COMPANY are not subject to tax as open-source software is free of charge and no tangible property is being transferred as a result of the maintenance services. Maintenance services alone are not taxable.

Authorities Contrary to the Taxpayer's View

COMPANY1's analysis and stance to charge the tax is based on the following statement from their tax advisory, "COMPANY1 transfers open-source software, not modified for customer need, to its customer's servers to be used indefinitely and provides support services which are not separately stated. In Illinois, sales tax applies to the transfer of canned software regardless of the method it is transferred. 86 Ill. Adm. Code § 130.1935(a). Illinois does not give any different consideration to open-source software. Sales tax applies to the entire charge made to the customer, including charges for updates. 86 Ill. Adm. Code § 130.1935(b). Further, sales tax applies to charges for training, installation, and consultation when they are not separately stated charges. 86 Ill. Adm. Code § 130.1935(b). As such, we maintain that the services purchased are taxable and we request payment for the balance due."

Request for Deletion of Trade Secret Information

No trade secret information is provided in this letter. Outside of the names of the interested parties, all information pertaining to this ruling can be disclosed.

Additional Documentation

If necessary, we are happy to provide any additional documents or information to assist in your review. Please let us know if you require any further clarification or supporting materials.

We appreciate your attention to this matter and look forward to receiving the Illinois Department of Revenue's guidance on this issue. Should you have any questions, or if you require further information, please do not hesitate to contact me at PHONE or EMAIL.

Thank you for your time and consideration.

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). The Department recently met and determined that it would decline to issue a Private Letter Ruling in response to your request. We hope, however, the following General Information Letter will be helpful in addressing your questions.

Retailers' Occupation Tax and Use 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. See 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. See 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. 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. If the purchases occur outside Illinois, purchasers must self-assess their Use Tax liability and remit it directly to the Department.

Computer Software

"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. If all the criteria listed in subsection (a)(1) of Section 130.1935 are met, then neither a transaction involving the licensing of that computer software nor the subsequent software updates for that software will be considered a taxable retail sale subject to Retailers' Occupation and Use Taxes. See 86 Ill. Adm. Code 130.1935(a)(1)(A)-(E).

Maintenance Agreements

In general, maintenance agreements that cover computer software are treated the same as maintenance agreements for other types of tangible personal property. See 86 Ill. Adm. Code 130.1935(b). The taxation of maintenance agreements is discussed in subsection (b)(3) of Section 140.301 of the Department's administrative rules under the Service Occupation Tax Act. See 86 Ill. Adm. Code Sec. 140.301(b)(3). The taxability of agreements for the repair or maintenance of tangible personal property depends upon whether charges for the agreements are included in the selling price of the tangible personal property. If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. In those instances, no tax is incurred on the maintenance services or parts when the repair or servicing is performed. A manufacturer's warranty that is provided without additional cost to a purchaser of a new item is an example of an agreement that is included in the selling price of the tangible personal property.

If agreements for the repair or maintenance of tangible personal property are sold separately from tangible personal property, sales of those agreements are not taxable transactions. However, when maintenance or repair services or parts are provided under those agreements, the service or repair companies will be acting as service providers under provisions of the Service Occupation Tax Act that provide that when service providers enter into agreements to provide maintenance services for particular pieces of equipment for stated periods of time at predetermined fees, the service providers incur Use Tax based on their cost price of tangible personal property transferred to customers incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3). The sale of an optional maintenance agreement or extended warranty is an example of an agreement that is not generally a taxable transaction.

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If, under the terms of a maintenance agreement involving computer software, a software provider provides a piece of object code (“patch” or “bug fix”) to be inserted into an executable program that is a current or prior release or version of its software product to correct an error or defect in software or hardware that causes the program to malfunction, the tangible personal property transferred incident to providing the patch or bug fix is taxed in accordance with the provisions discussed above.

In contrast to a patch or bug fix, if the sale of a maintenance agreement by a software provider includes charges for updates of canned software, which consist of new releases or new versions of the computer software designed to replace an older version of the same product and which include product enhancements and improvements, the general rules governing taxability of maintenance agreements do not apply. This is because charges for updates of canned software are fully taxable as sales of software under Section 130.1935(b). Please note that if the updates qualify as custom software under Section 130.1935(c), they may not be taxable.

Therefore, if a maintenance agreement provides for updates of canned software, and the charges for those updates are not separately stated and taxed from the charges for training, telephone assistance, installation, consultation, or other maintenance agreement charges, then the whole agreement is taxable as a sale of canned software. If, however, the updates of canned software included in the maintenance agreement consist solely of software distributed under open-source license provisions at no charge, then, even if the software is not separately itemized on the invoice, no Retailers’ Occupation Tax or Use Tax is owed because the taxable base is zero.

I hope this information is helpful. If you have further questions you may contact me at (217) 782-7055. If you have further questions related to the Illinois sales tax laws, please visit our website at <https://tax.illinois.gov/> or contact the Department’s Taxpayer Information Division at (800) 732-8866.

Very truly yours,

Kimberly Rossini
Associate Counsel

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