

This letter discusses whether certain software agreements qualify as licenses of software and not retail sales of software under the Retailers' Occupation Tax Act. See 86 Ill. Adm. Code 130.1935. (This is a PLR.)

August 10, 2007

Dear Xxxxxx:

This letter is in response to your letter dated December 5, 2006, in which you request 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 1200.1120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to CLIENT for the issue or issues presented in this ruling, and is subject to the provisions of subsection (e) of Section 1200.110 governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither CLIENT nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request. In your letter you have stated and made inquiry as follows:

CLIENT has retained FIRM to represent it before the Illinois Department of Revenue with respect to Illinois state and local sales and use taxes and their recent Voluntary Disclosure agreement for the period of January 2002 to current periods. A Limited Power of Attorney authorizing FIRM to act on behalf of the Client as Taxpayer's Representative is attached as Exhibit I.

Our CLIENT recently completed a Voluntary Disclosure Agreement with Illinois Department of Revenue. Our Client is headquartered in STATE and does not maintain a business location in your state. The Client provides financial advisory, risk management and general business consulting services. Based on our review of your State's statutes and regulations, these services are not subject to sales and use taxes.

However, beginning in 2002, they also began licensing canned software and provided software related services to their financial advisory customers. It recently came to their attention that the canned software licensing and related services may be subject to sales and use taxes. The software is installed by our Client at their customer's site. The software license agreement relates to the software license and the related

maintenance services. The maintenance services do include updates, upgrades, and fixes to the current version of the software. The management agreement provides professional services including consulting, integration, implementation, installation, customization, training, and training materials.

During the Voluntary Disclosure, our Client contacted their customers to determine their customers' taxability status and to determine if the customer had already accrued and remitted the use tax to the Department of Revenue. A few customers responded. Our Client completed the voluntary disclosure agreement and remitted sales and use tax on their Illinois software licenses sales. After the agreement was completed, our Client contacted any non-responsive customers a second time to recoup the taxes remitted by our Client through the Voluntary Disclosure Agreement. Two customers responded that the software sold by our Client is not taxable based on Title 86 Part 130, Section 130.1935(a)(1). This section provides the following 5 requirements for a license of software to not be taxable:

'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 of 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 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.'

Since our Client has already remitted the sales and use taxes and has already gone through the Voluntary Disclosure Agreement, our Client would like the Illinois Department of Revenue to review two examples of their software license agreements and issue a Private Letter Ruling. All of the customer-specific information has been removed from the two enclosed software license agreement examples. Our Client respectfully requests the Illinois Department of Revenue to review the license agreements (Exhibit II and III) and respond in writing their findings.

Since tax was already remitted on the license agreements in question through a Voluntary Disclosure Agreement, our Client respectfully request [sic] the taxability analysis expedited, if at all possible. It is our understanding that if the tax was paid in error the process to recoup any erroneously paid tax remitted through a Voluntary Disclosure Agreement is a lengthy process involving submitting a refund claim. So before going through that process, our Client wants to ensure the license agreements are truly not taxable.

To the best of the knowledge of both the taxpayer and the taxpayer's representative the Department has not previously ruled on the same or a similar issue for the taxpayer or a predecessor, and the taxpayer or any representatives have not previously submitted the

same or a similar issue to the Department but withdrew it before a letter ruling was issued.

Thank you for your consideration in this matter. If you have any questions, please contact me.

DEPARTMENT'S RESPONSE

As set forth in the Department's regulation for computer software at 86 Ill. Adm. Code 130.1935(a)(1)(A-E), "[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 of 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.

Based upon a review of Exhibit II, requirement (A) is met as seen on page 8, requirements (B) – (D) are met by Section 2.3, and requirement (E) is met under Section 8.6. As a result, the Exhibit II agreement qualifies as a license of software that is not a taxable retail sale.

Based upon a review of Exhibit III, requirement (A) is met on page 7, and requirements (B) – (D) are met by Section 2.3. Requirement (E) is covered by 4.1(a), which includes the program software, documentation and other information as confidential information. Section 4.1(e) requires that on expiration or termination of the license agreement, the confidential information must either be returned or destroyed. As a result, the Exhibit III agreement qualifies as a license of software that is not a taxable retail sale.

The factual representations upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the factual representations recited in this ruling are correct and complete. This Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this letter under the provisions of 2 Ill. Adm. Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

If you have further questions concerning this Private Letter ruling, you may contact me at (217) 782-2844. 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,

Terry D. Charlton
Chairman, PLR Committee

TC/MPM:msk