

A license of canned software is subject to Retailers' Occupation Tax liability if all of the criteria for an exempt license of canned software set out in 86 Ill. Adm. Code 130.1935(a)(1) are not met. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

November 25, 2008

Dear Xxxxx:

This letter is in response to your letter dated March 14, 2008, 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 1200.120. 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:

COMPANY is requesting a General Information Letter from the Illinois Department of Revenue, as permitted under Admin. Code 1200.120. The facts of our situation are as follows:

COMPANY is an Illinois based company that sells computer hardware, software and related services at the wholesale and retail level. COMPANY made a sale to their customer for Novell Software Licenses. These Novell licenses are for canned software, not custom software. Per Title 86, Part 130 Section 130.1935(a)(1) - 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 or 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.

Customer has provided COMPANY a copy of a Master License Agreement between them and Novell (Licensor). Customer has asked COMPANY to exempt their purchase of the Novell Software licenses from tax due to the provided Master License Agreement. Per COMPANY's review of the signed Master License Agreement, it does appear that all points of Title 86, Part 130 Section 130.1935(a)(1) have been met except for point B. However, within the Master License Agreement, under heading # 3 LICENSING it states 'The license grants and restriction for the software are contained in the End User License Agreement (EULA) accompanying the software. A copy of the EULA is available from Novell upon request or can be obtained at <http://www.novell.com/licensing/eula/>.' COMPANY obtained the attached unsigned End User License Agreement (EULA) from the referenced website in the Master License Agreement. The EULA does meet point B of Title 86, Part 130 Section 130.1935(a)(1), as well as points C, D and E. The EULA does not meet point A because the EULA is not signed by either party. It is important to note that by signing the Master License Agreement the customer is committed to the acceptance of the End User License Agreement (EULA).

Considering the facts as outlined above, our concerns are as follows:

- 1) Will the signed Master License Agreement in combination with the End User License Agreement (EULA) referenced in the Master License Agreement, satisfy the requirements of Title 86, Part 130 Section 130.1935(a)(1)? Do both documents together support that our sale for a license of software is not a taxable retail sale?
- 2) If yes to #1, can COMPANY utilize the above referenced documentation to support an exempt sale of Novell licenses of software to their customer when COMPANY is not referenced as a party in the Master Software License Agreement?

We believe the answer to both questions is in the affirmative. Please review the attached documentation and let us know of your decision on this matter.

DEPARTMENT'S RESPONSE

We regret that, in the context of a GIL, we cannot respond to your questions in the requested format. However, we are providing the following general information for your consideration.

Generally, sales of "canned" computer software are taxable retail sales in Illinois. Sales of canned software are taxable regardless of the means of delivery. For instance, the transfer or sale of canned computer software downloaded electronically would be taxable. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See 86 Ill. Adm. Code 130.1935(c). Custom computer programs or software must be prepared to the special order of the customer.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under Section 130.1935(c), they may not be taxable. But, if

maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreements would be taxable as sales of canned 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.

Generally, a license of canned software is subject to Retailers' Occupation Tax liability if all of the criteria set out in 86 Ill. Adm. Code 130.1935(a)(1) are not met. In some circumstances, however, if the document that is signed by the licensor and the customer does not contain all the terms of the agreement that meet the criteria required under part (a)(1) of Section 130.1935 but clearly incorporates additional documentation that contain the missing criteria and obligates the customer to those terms, the license of software as a whole may qualify as a nontaxable sale of canned computer software.

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,

Debra M. Boggess
Associate Counsel

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