

Charges for updates of canned software are fully taxable as sales of software under Section 130.1935(b) of the Department's rules. If a maintenance agreement provides for updates of canned software (other than "patches" or "bug fixes"), and the charges for those updates are not separately stated and taxed, then the whole agreement is taxable as a sale of canned software. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

December 8, 2008

Dear Xxxxx:

This letter is in response to your letter dated July 2, 2007, 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 Department declines to issue a private letter ruling in this case. However, we hope the following general information will be helpful in addressing the issue you raise. In your letter you have stated and made inquiry as follows:

Our firm has been retained by ABC to review their operations for compliance on Retailers' and Service Occupation and Use Taxes (ROT, RUT, SOT and SUT) for the periods from 1/1/2004 through 12/31/2006. Form IL-2848 Power of Attorney is enclosed.

During our review, questions arose relating to the taxability of software maintenance agreements. ABC is not currently under audit by the Illinois Department of Revenue and has no litigation pending with the Department relating to this issue. To the best of our knowledge, the Department has not issued any previous rulings to ABC on this issue and no previous requests for a private letter ruling have been made.

ABC made several purchases of software and software maintenance agreements. All of the software involved is canned rather than custom and the purchases may have been delivered either electronically over the Internet or on tangible media. The software and maintenance agreements are for non-manufacturing related activities. We understand that the initial software purchases are subject to ROT or RUT regardless of the method

of delivery. The facts relating to the maintenance agreements in question are as follows:

- 1) The maintenance agreement cost is either identified as a separate line item at the time of the original software purchase or invoiced separately at a later date.
- 2) The maintenance agreements include software updates or enhancements (when and if they become available) and technical support to be given either through e-mail or telephone contact.
- 3) The costs relative to obtaining updates and technical support are not separately stated on the invoices or identified in the maintenance agreements.

Our initial analysis of the treatment of software and maintenance agreements indicates that the maintenance agreements would not be subject to ROT or RUT. 86 Ill. Adm. Code 130.1935(b) specifies that these agreements are to be treated in the same manner as other maintenance agreements and that the sellers would be responsible for tax on their cost of any materials transferred under the agreement. This position is supported by 86 Ill. Adm. Code 140.141(c)(1) which also provides that maintenance agreements are not subject to ROT or RUT. Additionally, Illinois Department of Revenue Private Letter Ruling ST 06-0010-PLR confirms our position.

However, ABC's software vendors assert that the maintenance agreements are subject to ROT. These vendors have cited Illinois Sales & Use Taxation of Computer Software-Release 16 (2007-2008). Although this Release cites 86 Ill. Code 130.1935 providing that computer hardware and software maintenance agreements are to be treated in the same manner as other maintenance agreements that are not subject to ROT, the Release goes on to state that '...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.' This position appears to be inconsistent with the provisions of 86 Ill. Adm. Code 140.141 dealing with warranties and maintenance agreements where there is no requirement for any parts or materials to be separately stated from the service components in order for the agreements to be outside the parameters of ROT. During further research, we also located IL ST-05-0028-PLR that also states '...if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the entire agreements would be taxable as sales of canned software.'

It is difficult to follow the logic for the IL DOR to assert application of ROT or RUT on the entire price of maintenance agreements for canned software based on the provision that they would include any potential updates along with technical support services. This appears to be contrary to the normal handling of maintenance agreements that provide for both transfers of tangible personal property (parts or materials) and services. Additionally, there may not be any updates to the software during the period of the agreements in which case no taxable components would be transferred.

We respectfully request a Private Letter Ruling on behalf of ABC relating to the proper application of Illinois taxes for software maintenance agreements. Please send your response to:

NAME/ADDRESS

Thank you for your consideration of this matter.

DEPARTMENT'S RESPONSE:

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 Sec. 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.

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.

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 the factual representations recited in this ruling.

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. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).]

Sincerely,

Samuel J. Moore
Associate Counsel