

This letter discusses sales of software. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

December 10, 2008

Dear Xxxxx:

This letter is in response to your letter dated June 16, 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 a business to business seller of proprietary networking software. We are headquartered in CITY/STATE and sell primary [sic] to large networking companies.

Nexus: Please note COMPANY employees [sic] 1 employee working from a home office in Illinois. We would like to request an official ruling from your state in regards to sales tax on the following transactions. Specifically we need to know if COMPANY is responsible for charging and remitting the sales tax for the following items:

1. Standard Out of the box Software delivered by:
A. Electronically Taxable _____ Non-Taxable _____
B. Hard Disk Taxable _____ Non-Taxable _____

Comments _____

2. Custom Software delivered by:
A. Electronically Taxable _____ Non-Taxable _____
B. Hard Disk Taxable _____ Non-Taxable _____

Comments _____

3. Software Maintenance agreement for Standard Out of the box Software
A. Electronically Taxable _____ Non-Taxable _____

B. Hard Disk Taxable _____ Non-Taxable _____

Comments _____

4. Software Maintenance agreement for Custom Software
A. Electronically Taxable _____ Non-Taxable _____
B. Hard Disk Taxable _____ Non-Taxable _____

Comments _____

5. Training on Standard Out of the box Software delivered by:
A. On-Site Training Taxable _____ Non-Taxable _____
B. Phone/Web Conference Training Taxable ____ Non-Taxable ____

Comments _____

6. Training on Custom Software delivered by:
A. On-Site Training Taxable _____ Non-Taxable _____
B. Phone/Web Conference Training Taxable ____ Non-Taxable ____

Comments _____

7. Customer Support via phone support on Standard Out of the box Software
Taxable _____ Non-Taxable _____

Comments _____

8. Customer Support via phone support on Custom Software
Taxable _____ Non-Taxable _____

Comments _____

9. On Site Customer Support on Standard Out of the box Software
Taxable _____ Non-Taxable _____

Comments _____

10. On Site Customer Support on Custom Software
Taxable _____ Non-Taxable _____

Comments _____

11. Software License Agreement - renewable on a yearly basis delivered by:
A. Electronically Taxable _____ Non-Taxable _____
B. Hard Disk Taxable _____ Non-Taxable _____

Comments _____

12. On Site Installation of Custom Software
Taxable _____ Non-Taxable _____

Comments _____

13. On Site Installation of Standard Out of the box Software
Taxable _____ Non-Taxable _____

Comments _____

Feel free to contact NAME with any questions.

DEPARTMENT'S RESPONSE:

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 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 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois.

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. For your general information see of 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax. The provision of engineering, design, consulting services or project management services that do not include the transfer of tangible personal property with the provision of the such services does not result in Service Occupation Tax or Use Tax liability. The transfer of any tangible personal property such as, for example, written reports, tangible media (CDs) and training manuals incident to a sale of service and would be subject to liability.

Information or data that is electronically transferred or downloaded is not considered the transfer of tangible personal property in this State. See 86 Ill. Adm. Code 130.2105(a)(3). However, canned computer software is considered taxable tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means or other media. See 86 Ill. Adm. Code 130.1935. If the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See Section 130.1935(c). 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.

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 Section 130.1935(c)(3).

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or 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.

Please note that acceptance of a software license agreement by clicking "accept" while online is not considered "acceptance" sufficient enough to constitute a written agreement signed by the licensor and the customer for purposes of subsection (a)(1)(A) of Section 130.1935.

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.

Assuming that any services provided, such as installation, phone support, training, and seminars, do not require the transfer of tangible personal property to the recipients of those services, charges for such services are exempt if they are separately stated from the selling price of canned software. See Section 130.1935(b). If computer software training or other support services are provided in conjunction with a sale of custom computer software or a license of computer software, the charges for that training are not subject to tax.

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,

Richard S. Wolters
Associate Counsel

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