

This letter discusses a business that re-licenses software and resells maintenance agreements. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

September 25, 2006

Dear Xxxxx:

This letter is in response to your letter dated May 30, 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 1200.120. You may access our website at www.ILTAX.com 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:

We have recently registered to do business in the state of Illinois and have a few questions. We design and sell our own software products and we also resell a software product and maintenance as a value added reseller.

We recently received an order from a new customer to provide maintenance services on the software product that we resell. We purchase the maintenance services from the original licensor and mark this up and resell this to the end user. Telephone support, bug fixes, minor software updates are included in this price. **Since we are not the original licensor of this software product, would this product therefore be considered "canned software"? Or as a reseller, could we have the customer sign a written statement agreeing to the terms of the original licensor's licensing agreement.** This licensing agreement meets all of the conditions of 86 Ill. Admin Code.1935(a) [sic] except that it would not be signed by the original licensor and the end user but rather between the reseller(us) [sic] and the end user.

If the software is considered "canned software" and thus taxable for sales taxes, would the maintenance agreement be taxable also?

Also, do the provisions of Section 3-75 of the Use Tax Act that provide that personal property purchased by a serviceman is subject to Use Tax when

purchased for transfer by the serviceman incidental to completion of a maintenance agreement apply to software? Does this apply to software updates that would be included as it is released as part of the amount we pay for maintenance? We pay the original licensor 10% of the purchase price of the software for the applicable maintenance and then resell it at 18% of the purchase price of the software. Do we have to pay tax on 50%(the [sic] presumed amount included as software) of the 10% cost or do we simply charge the end user sales taxes on the entire amount? The question is, how much tax is paid? Is there a use tax that must be paid by us using the serviceman provision above and then also a sales tax that we have to collect from the end user?

Also, if we sell both our own software products and the product that we resell in a single customer deal, could we use a licensing agreement that combines the licenses of both our product and the product that we resell into one agreement(that [sic] includes all of the requirements of Admin Code 1935(a)to [sic] enable all of the software products to be exempt from tax?

Thank you for your assistance in this matter.

DEPARTMENT'S RESPONSE

We do not have enough information to provide you with specific answers to your questions. However, for general information regarding computer software, we suggest you review the Department's regulation "Computer Software" at 86 Ill. Adm. Code 130.1935.

Generally, sales of "canned" computer software are taxable retail sales in Illinois. 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.

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). Without knowing what if any changes you make to the software that you re-license, we do not know whether this software is canned computer software or custom. If you are simply re-licensing the software without making any changes to it, it is most likely canned.

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.

Again, without seeing the agreement between you and your customer, we are unable to determine whether it would qualify for a license of software.

In general, maintenance agreements that cover computer software and hardware are treated the same as maintenance agreements for other types of tangible personal property. The taxability of maintenance agreements is dependent upon whether the charge for the agreement is included in the selling price of tangible personal property. If the charge for a maintenance agreement is included in the selling price of tangible personal property, that charge is part of the gross receipts of the retail transaction and is subject to Retailers' Occupation Tax liability. No tax is incurred on the maintenance services or parts when the repair or servicing is completed.

If maintenance agreements are sold separately from tangible personal property, the sale of the agreement is not a taxable transaction. However, when maintenance services or parts are provided under the maintenance agreement, the company providing the maintenance or repair will be acting as a service provider under the Service Occupation Tax Act. The Service Occupation Tax Act provides that when a service provider enters into an agreement to provide maintenance services for a particular piece of equipment for a stated period of time at a predetermined fee, the service provider incurs Use Tax based upon its cost price of tangible personal property transferred to the customer incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3).

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 agreement would be taxable as sales of canned software.

Assuming that the 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 qualifying license of computer software, the charges for that training are not subject to tax.

If you require additional information, please visit our website at www.ILTAX.com 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).

Very truly yours,

Martha P. Mote

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