

This letter concerns the taxation of computer software transactions. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

March 29, 2011

Dear Xxxxx:

This letter is in response to your letter received in this office on September 28, 2010, 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:

On behalf of our client (hereinafter 'Taxpayer'), we are requesting a Private Letter Ruling ('PLR') regarding the sale of authentication and resolution services on a subscription basis through provision of a digital certificate. An executed Power of Attorney form authorizing FIRM to represent the Taxpayer in this matter is enclosed. To the best knowledge of Taxpayer and FIRM: (1) the Illinois Department of Revenue ('Department') has not previously ruled on the same or similar issue for the Taxpayer or a predecessor;¹ (2) the same or similar issue was not previously submitted and withdrawn by Taxpayer or FIRM prior to the Department's issuance of a PLR; and (3) Taxpayer is not under audit by or involved in litigation with the Department.

DESCRIPTION OF SERVICES

The Taxpayer is a provider of authentication solutions for businesses and individuals seeking to perform secure electronic commerce and communications over the internet. One such solution is the provision of a digital certificate and authentication and resolution services on a subscription basis.

Digital certificates are commonly used to facilitate the secure transmissions between end user browsers and the Taxpayer's customers' ('customers') servers. A digital certificate allows an end user to recognize that they are, indeed, accessing the customers' server [sic]. For illustration purposes, assume 'InternetRetailer.com' is a

customer of the Taxpayer. An end user of 'InternetRetailer.com' will access the website and know that they are accessing the real 'InternetRetailer.com' site and not a fake site, because a check mark will appear on the real 'InternetRetailer.com' site, indicating that the website is authenticated by the Taxpayer. This check mark, trademarked by the Taxpayer and recognized throughout the world, serves as the visible indication on the end user's screen that the customer's site is who it purports to be.

A digital certificate is provided through an online process, and the first step in this process is the customer's access of the Taxpayer's online portal to complete a registration form. As part of the customer's request of a certificate through registration, a private and public key pair is generated by the customer's web server. The private key is retained by the customer on its web server. The public key is part of the information sent to the Taxpayer in the registration process.

The Taxpayer performs all due diligence necessary to authenticate the identity of the applicant, the related website and business, and the information presented by the customer during the registration process, including the public key. Once the Taxpayer authenticates the identity of the applicant, a digital certificate is electronically sent to the customer. A digital certificate is a flat file containing: the customer's public key, metadata with information such as certificate expiration date, the certificate owners' [sic] name, the name of the issuer (certification authority, i.e. the Taxpayer), serial number of the certificate, and an electronic signature of the issuer.² The flat file does not contain binary code.

The digital certificate is installed by the customer on a customer's web server. When end users connect to the customer's server through a web browser, the browser establishes the authenticity of the digital certificate (and thus the authenticity of the web site) by mathematically proving that the certificate presented by the customer's web server was digitally signed by the Taxpayer. The digital certificate also contains the aforementioned public key. It is described as a 'public' key because the digital certificate (and key contained therein) is readily viewable by any browser.

The end user's web browser creates a session key that is used to encrypt the transmission between the customer's server and the end user's browser. However, the end user's browser must first use the public key to encrypt the session key and then transmit the session key to the web server. The web server will use the private key to decrypt the session key so that both the web server and browser can begin using the session key for the encrypted transmissions. After the initial handshake between the browser and web server, the session key is used for the encryption of the transmissions. The encryption strength of the transmission is directly related to the bit length of the session key. The encryption/decryption is performed by the cryptographic software built into the web browser and customer's server. This software is not provided by the Taxpayer.

In addition to authenticating the digital certificate and website, the end user's browser communicates with the Taxpayer's servers to verify that the digital certificate is valid and not revoked (resolution service). If the certificate is valid, the end user's browser will show the end user a notification that the certificate is valid and has not been revoked. The charges for the authentication service, digital certificate, and resolution service are part of a lump sum subscription charge and must be renewed periodically.

ISSUE

Whether the Taxpayer's sales of authentication services via provision of a digital certificate to the Taxpayer's customers for consideration are subject to the Illinois sales/use tax when provided to customers located in Illinois.

RULINGS REQUESTED

I. Taxpayer's sales of digital certificates are exempt from Illinois sales and use taxes (ROT, SOT, SUT and UT), because the transaction does not involve the transfer of tangible personal property.

II. Taxpayer's provision of authentication services is exempt from Illinois sales and use taxes (ROT, SOT, SUT and UT), because the transaction is a service that does not involve the transfer of tangible personal property incident to the service.

III. Taxpayer's provision of resolution services is exempt from Illinois sales and use taxes (ROT, SOT, SUT and UT), because the transaction is a service that does not involve the transfer of tangible personal property incident to the service.

BASIS FOR OUR RULINGS REQUESTED

I. The digital certificates issued by the Taxpayer to its customers are not delivered via a tangible medium and are not computer software.

The Illinois Retailer's [sic] Occupation Tax ('ROT') is imposed on persons engaged in the business of selling tangible personal property at retail.³ The ROT is imposed on all sales at retail of tangible personal property unless specially exempted from tax or exempted from the definition of 'sale at retail.'

The digital certificate provided by the Taxpayer is not tangible personal property as it is delivered entirely over the internet.

In Illinois, canned software is considered to be tangible personal property regardless of the form in which it is transferred or transmitted.⁴ Computer software is defined as a set of statements, data, or instructions that is used directly or indirectly in a computer in order to bring about a certain result.⁵

The digital certificates provided by the Taxpayer do not constitute computer software as they do not provide a set of statements, data, or instructions that is used directly or indirectly in a computer in order to bring about a certain result. The certificate is a flat file containing only information (a public key, metadata with information such as certificate expiration date, the certificate owners [sic] name, name of the issuer, serial number, electronic signature, etc.). The flat file does not contain binary code and does not dictate statements, data or instructions that is used directly or indirectly to bring about a certain result.

Under Illinois law, information or data that is transferred or downloaded electronically is not considered tangible personal property.⁶ Therefore digital products, including data and information transmitted through an electronic medium such as the Internet, would not be considered tangible person [sic] property subject to the ROT.

In a previously-issued General Information Letter ('GIL'), the Department concluded that electronically downloaded books are not subject to tax, because they involve only the transfer of data and information.⁷ In two more recently-issued GILs, the Department reinforced its position that any data or information transferred or downloaded over the internet is not considered a transfer of tangible personal property.⁸

The digital certificates sold by the Taxpayer are akin to a digital product in that only data or information is being conveyed. In the case of the provision of digital certificates by the Taxpayer, nothing is downloaded to the user's computer. There is no transfer of tangible personal property and the entire transaction is conducted electronically via the Internet. Therefore the digital certificates would not be considered transfers of tangible personal property and are not subject to tax.

II. The services associated with authenticating the digital certificate are not taxable services in the state.

The Illinois service occupation tax ('SOT') is imposed on persons engaged in the business of making sales of services.⁹ In general, SOT is levied on persons making sales of services and is measured by the selling price of any tangible personal property transferred that is incidental to the sale of the service.¹⁰ Therefore, when no tangible personal property is transferred in relation to a service, the service is not subject to SOT.

The Taxpayer's authentication services consist primarily of due diligence procedures to verify the identity of its customer (and the customer's website). Once verified, the digital certificate is then installed by the customer onto the customer's server. All further encryption and decryption is performed entirely by software built into the web browser and the customer's server. This is not software provided by the Taxpayer.

Although the Taxpayer's authentication services are not specifically enumerated in the Illinois statute, they may be considered analogous to a security monitoring, data processing, or information service.

In previously-issued GILs, the Department has reiterated the statutory guidance that a service is not subject to SOT if no tangible personal property is transferred, and has applied this rule to services such as data processing,¹¹ as well as security services.¹² As discussed herein, the Taxpayer provides no tangible personal property with its digital certificates. Similarly, there is no tangible personal property transferred with the authentication services the Taxpayer provides.

In an Illinois Private Letter Ruling, the Department established that a taxpayer who provided electronic business and financial information through a database via the Internet was not subject to tax on its sales of web-based information services.¹³ This ruling further reinforces our position that the Taxpayer's web based authentication services would not be subject to the SOT, as there is no tangible personal property transferred with the service.

III. The resolution services provided by the Taxpayer to verify the digital certificate are not taxable services in the state.

The resolution service is provided by the Taxpayer after the digital certificate is obtained. The resolution service allows the end user's browser to verify that the digital certificate is, indeed, valid and not revoked.

This resolution service is also not taxable in Illinois. As previously stated, SOT is levied on persons making sales of services and is measured by the selling price of any tangible personal property transferred that is incidental to the sale of the service.¹⁴ Therefore, when no tangible personal property is transferred in relation to a service, the service is not subject to SOT.

As the resolution service is not enumerated as taxable by Illinois law, and it is not performed on a tangible media, it is not taxable in the state.

Requested Action

We request that the Illinois Department of Revenue review the stated facts and issue a ruling that the Taxpayer's digital certificate and authentication processes is [sic] not subject to Illinois ROT or SOT.

A copy of our executed Power of Attorney, Form IL-2848, is enclosed. If you have any questions, please contact me.

DEPARTMENT'S RESPONSE:

The Department's regulation "Public Information, Rulemaking and Organization" provides that "[w]hether to issue a private letter ruling in response to a letter ruling request is within the discretion of the Department. The Department will respond to all requests for private letter rulings either by issuance of a ruling or by a letter explaining that the request for ruling will not be honored." 2 Ill. Adm. Code 1200.110(a)(4). The Department declines to issue a Private Letter Ruling. Although we are not providing you with a Private Letter Ruling, we hope the following general information will be of assistance.

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 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax. Services that involve the transfer of tangible personal property (such as, for example, written reports, other tangible media and training manuals) incident to a sale of service may be subject to either Service Occupation Tax liability or Use Tax 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).

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.

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.

As noted in a prior General Information Letter (ST 01-0148) issued by the Department, a digital signature or identification is not considered computer software and is therefore not subject to tax; however, any software used to create, encrypt, decrypt or read a digital signature is considered to be software and may be subject to taxation. Generally, the provision of a digital certificate, authentication and resolution services are not subject to tax. However, any canned computer software or any other tangible personal property provided to the customer with the provision of the digital certificate or services may be 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

RSW:msk

¹ Our review of the publically-available General Information Letters (GIL) issued by the Illinois Department of Revenue revealed one GIL with facts similar to our taxpayer. Please see ST 01-0148-GIL. To our knowledge, our client did not submit this ruling request.

² Note that the exact contents of a certificate adhere to certain established standards such as the 'X509' standard that specifies what can or cannot be contained on a certificate.

³ 35 Ill. Comp. Stat. 120/1; Ill. Admin. Code tit. 86, § 130.101.

⁴ Ill. Admin. Code tit. 86 § 130.1935(a).

⁵ 35 Ill. Comp. Stat. 105/3-25.

⁶ Ill. Admin. Code tit. 86 § 130.2105(a)(3).

⁷ Illinois Dept. of Rev. General Information Letter No. ST 07-0068-GIL (06/19/2007).

⁸ Illinois Dept. of Rev. General Information Letter No. ST 09-0098-GIL (07/30/2009); Illinois Dept. of Rev. General Information Letter No. ST 10-0010-GIL (02/26/2010).

⁹ Ill. Admin. Code tit. 86, § 140.101.

¹⁰ Ill. Admin. Code tit. 86, § 140.101(b)(1); Ill. Admin. Code tit. 86, § 160.101(c)(1).

¹¹ Illinois Dept. of Rev. General Information Letter No. ST 07-0125 GIL (08/16/2007).

¹² Illinois Dept. of Rev. General Information Letter No. ST 99-0311 GIL (10/13/1999).

¹³ Illinois Private Letter Ruling No. ST 04-0013 (10/27/2004).

¹⁴ Ill. Admin. Code tit. 86, § 140.101(b)(1); Ill. Admin. Code tit. 86, § 160.101(c)(1).