

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

January 6, 2012

Dear Xxxxx:

This letter is in response to your letter dated September 27, 2011, 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](http://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:

ABC has employees in Illinois and has been appropriately filing income and payroll tax returns with your state. We submitted a Voluntary Disclosure Agreement ('VDA') with your state, but rescinded it after discussions with a representative of your state indicated that our products and services were not subject to sales and use tax in Illinois. In order to confirm this position, we request a written ruling or advisory opinion from your state on the application of sales tax in the situations enumerated here below.

Illustrative Facts:

(01) ABC (or 'the Company'), provides hosted marketing services to clients that use email, direct mail and other marketing channels to reach their customers. Serving various industries, the Company's branded software platform and related services help clients evaluate their potential and existing customers, and then plan and implement marketing campaigns. Because its software platform is hosted, the Company can easily accommodate different types of clients or adapt it to existing clients' changing needs. The Company's clients include Airlines, Hotels, Retail Sales Stores, Auto Rental companies and a host of other Commercial and Retailing establishments. The Company enables its clients to increase revenue and customer engagement through successful email and cross-channel marketing.

(02) The Company is headquartered in STATE where all of its product development and hosting is performed. The Company has sales people in various states who solicit sales and forward orders to the Company's headquarter [sic] for acceptance.

(03) The Company has developed a proprietary software platform, or 'SOFTWARE,' that allows customers to create, manage and deliver email campaigns. The Company's software platform enables users to take information that they accumulate on their customers or prospects (such as their email address, demographic data, web browsing history and any other data about the customer) and apply search criteria against that information to derive a list of targeted recipients to whom a message is to be sent. Using the clients [sic] documents and marketing materials ('content'), a customized message can then be sent to each of the targeted recipients. Clients load their own content and data onto computers the Company maintains in its data centers. The software platform matches the content for each recipient based on the criteria that the client has entered into the software platform. The software platform then compiles the message and sends the message to the recipient. Clients load their own Content and data via the Internet and their data is kept separate from any data belonging to other clients of the Company. The software platform tracks the client's email history and activity, which is stored and made available to the client via web access. The Company does not sell or provide marketing data. The clients cannot download the SOFTWARE to perform the functions on their own computers.

(04) Clients of the Company use the SOFTWARE to send targeted emails to their prospects and customers. Emails are compiled from content and data that the client owns and stores either in its own systems or on computers in the Company's data centers. The Company never owns the data. That content and data is then compiled in a way that customized messages are sent to the recipients based on marketing campaigns or other types of communications the client wants to execute. While the vast majority of messages are sent via email, they can also be sent to a mobile device (e.g. cell phone or smart phone) or posted to a social site that the client maintains. Via web access, clients are able to monitor activity on campaigns they have launched, run reports on these campaigns and plan future campaigns.

(05) The messages are sent out of the Company's servers/data centers that are located in STATE. These data centers host the software platform, hold client data in electronic storage and house all the hardware, software and communications infrastructure to send out high volumes of messages. The equipment in these data centers also track message activity or events related to messages after they have been sent (open rates, bounce rates, etc.). Any data a client may keep in the system is stored in these data centers. Employees of the clients use the SOFTWARE via the web. These employees may be located anywhere. For example, a client based in Texas can have an employee in Arizona that logs into the Company's website to use the SOFTWARE on servers located in STATE. The client's employees can be located anywhere in the world and be able to access the SOFTWARE, as long as they have an Internet connection.

(06) The Company grants its clients a right to use the software platform on its server for a designated number of interactive users. Title to and ownership of the software platform, and all its related proprietary items, remain with the Company, and downloads of the proprietary software platform are not permitted. The Company does not sell the software platform, but provides its clients on-line remote access to its software platform. The Company's clients utilize the software platform as a tool to send marketing/advertising messages to their targeted customers. Instead, the Company

charges its clients a fee based on the number of messages the client sends to its customers via email, social, mobile, or the web. The Company offers its clients pricing plans on a CPM, or price-per-mille (thousand messages) basis, with the CPM generally dropping incrementally as the number of messages increase incrementally. The Company also offers and provides clients with professional services and charges for this separately from the messaging fees. These professional services are primarily provided on-line.

The client is charged the following fees depending on the order:

**Set-Up Fee** – To provide the client with access to the SOFTWARE.

**Messaging Fee** – Fees for messages sent through the software platform. Clients pay a minimum fee for use of the SOFTWARE based on the committed volume of messages, plus overages for messages sent in excess of the commitment. This constitutes 80% of the Company's business.

**Professional Services** – Fees for services that include (i) training on use of the SOFTWARE, (ii) consulting on best practices, (iii) creative services to design messages, and (iv) services to help execute campaigns. Fees for these services are on a time and materials or fixed fee basis. These services are primarily delivered out of the Company offices in STATES via the internet.

(07) The Company does not provide any tangible deliverables. The client uses the SOFTWARE to send messages to their targeted customers who may be located anywhere in the world. The client's employees may access the Internet from any location in the world to work on the SOFTWARE. It is not possible for the Company to identify the number of messages sent to any given state in the US. Invoices are based on the bill-to location of the client.

#### **Questions:**

- (1) The Company's clients use the Internet to remotely access the Company's software platform that is located in its STATE data centers. The software platform cannot be downloaded by the clients. Will your State consider such activity a taxable event in your State?

Will the answer change if the Company's SOFTWARE and software platform is on a server located in your State?

- (2) Is the Set-Up Fee taxable in your State? This is a one-time charge to set up the clients' access to the SOFTWARE. The Company does not provide on-site installations and no tangible property is delivered for the set-up.

If taxable, is there a special tax rate for such transactions?

- (3) Is the Messaging Fee taxable in your State? The Company provides no tangible deliverables to its clients in your State. The Company's clients use the Company's software platform located in data centers in STATE to send email messages to its targeted customers. The targeted customer can be anywhere in the world. The Company does not monitor the location of its client's targeted

customers. The Messaging Fee is based on the number of messages sent by the client.

If taxable, and there is a method for determining the State(s) of the targeted customers of the Company's client, is the tax allocable? If yes, what documents must the Company obtain from its clients to substantiate the non-taxable allocable portion?

If taxable, is there a special tax rate for such transactions?

- (4) The Company bills its clients based on their billing location address (since there are no tangibles delivered in your state). If the Messaging Fee is taxable in your State, will the answer change if the client's employees that access the SOFTWARE reside in another State?
- (5) Are Professional Services taxable in your State? The Company offers Professional Services that include:
  - (i) Training on use of the SOFTWARE
  - (ii) Consulting on best practices
  - (iii) Creative services to design messages, and
  - (iv) Services to help execute campaigns.

Charges for these services are either time and materials (i.e. hourly plus expenses) or fixed fee. These services are delivered out of the Company offices in STATES via the Internet.

What is the applicable tax rate for each of the service [sic] enumerated above?

Is the charge for 'Training' taxable if provided 'on-line' or in another state?

Does it make a difference if the charges are bundled or not?

Your prompt response will be greatly appreciated and will help in resolving our tax issue with our clients. If you have any question(s), please contact me.

#### **DEPARTMENT'S RESPONSE:**

General information letters are used to direct taxpayers to the Department's regulations and other sources of information for general guidance. You may find the Department's general information letters helpful in regards to many of the issues raised in your request. The Department's "Sunshine Letter" rulings are located on the Department's Internet website under the heading of "Laws/Regs/Rulings."

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.

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.

Please note that the Department has determined that the proper forum to determine the appropriate taxation of computer software Application Service Providers (ASPs), software hosting and web-based software is through a formal administrative rulemaking process rather than on a case-by-case basis through individual inquiries.

I hope this information is helpful. If you require additional information, please visit our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Debra M. Boggess  
Associate Counsel

DMB:msk