ST 12-0022-GIL 04/27/2012 COMPUTER SOFTWARE

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. (This is a GIL.)

April 27, 2012

Dear Xxxxx:

This letter is in response to your letter dated July 20, 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 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:

> My company has recently established nexus in Illinois. We are trying to verify whether or not the licensing and distribution of our software products qualifies as a taxable transaction in your state. The product is considered proprietary software which is licensed to our licensees under the exclusive legal right of our company. Our licensee is given the right to use the software under certain conditions, but restricted from other uses, such as modification, or reverse engineering. The product, however, is not a stand-alone, often referred to as 'canned' software, in that the customer cannot buy the software at retail. The proprietary software is always integrated into the licensee's product which would then go to an end user. This interpretation would make it more a wholesale item which would be exempt from sales tax for it is in effect a resale transaction.
>
> Our understanding of our license transactions, since we never license to an end user and the proprietary use of the software is always integrated into our customer's product, is that the licensing of our software should be exempt from your state's sales tax for the product is always sublicensed and essentially resold as part of our licensee's ('customer's') integrated product.
>
> As we would like to avoid any misunderstanding over this matter, we are requesting your state's legal opinion.

DEPARTMENT'S RESPONSE:

Generally, sales of “canned” computer software are taxable retail sales in Illinois. Canned computer software is considered to be tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means, or other media. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. 86 Ill. Adm. Code 130.1935. Computer software that is not custom software is considered to be canned computer software, whether it is “stand-alone” or not.

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 a transaction for the licensing of computer software meets all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software nor 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.

If a transaction for the licensing of computer software does not meet all of the criteria provided in Section 130.1935(a)(1), then the transfer of the software is subject to Retailers’ Occupation Tax, unless the transaction qualifies for some other exemption, such as the resale exemption discussed in Section 130.1935(a)(2). That subsection provides that “[v]alue added resellers who acquire software for relicensing or transfer to consumers after modification or adaptation of the software may acquire the software as a sale for resale by presenting their suppliers with valid certificates.”

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.

Sincerely,

Samuel J. Moore
Associate Counsel

SJM:msk