

ST 13-0027-GIL 05/28/2013 COMPUTER SOFTWARE

This letter concerns computer software maintenance agreements. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

May 28, 2013

Dear:

This letter is in response to your letter dated March 15, 2013, 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:

I would like to request a Letter of Ruling regarding IL Sales and Use Tax on Software and Hardware Maintenance agreements. We are an IT Consultant and a reseller of various technology related equipment, software, etc. Part of what we resell are maintenance agreements offered by software and hardware manufacturers. These agreements are sold separately from the initial product or software license. A description of each is below:

**Hardware Maintenance:** A maintenance contract offered by the manufacturer of the product that is usually renewed on an annual basis. These agreements typically offer support (telephone, e-mail, etc), software patches and updates to the product and extended warranty replacement of the product if it were to fail. An example of this would be COMPANY1 and their COMPANY1 warranty service. As long as you have the product covered under COMPANY1 you are entitled to product support from COMPANY1, updated COMPANY1 software to run on the product, and warranty repair or replacement of the product if it were to fail.

**Software Maintenance:** A maintenance contract offered by creator of the software that is usually renewed on an annual basis. These agreements typically offer support (telephone, e-mail, etc), and software patches and updates. An example of this would be a COMPANY2 Anti-Virus renewal. The original purchase of the software includes 1 year of support and updates (we are aware that the original purchase of software is taxable). After the initial year, the end user renews their maintenance on an annual basis. This software maintenance entitles the end user to ongoing support and product patches / updates.

I have called the IL Taxpayer Assistance line several times regarding these types of agreements. Every time I have called to verify the tax laws regarding a different type of

agreements from a different vendor, I am always told the same thing: "Under 130.1935, Section b it states that software maintenance is treated the same as hardware maintenance, and that under 140.301 Section b3 it states that as long as there is no transfer of tangible personal property that the sale is exempt from Sales and Use taxes". Most recently I spoke with Eric (badge 15520).

However, one of our customers in IL is currently undergoing an audit and has been told that they should have been charged tax on all their software maintenance agreements they purchased from us. Since this seems to be an unclear section of the tax code, I would like to request a Letter of Ruling so that we have a definitive answer to this question and can collect Sales and Use tax in the correct manner.

Thank you for your time.

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

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 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

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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.

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,

Richard S. Wolters  
Associate Counsel