ST 13-0032-GIL 06/19/2013 COMPUTER SOFTWARE

A license of canned software is subject to Retailers' Occupation Tax liability if all of the criteria set out in 86 Ill. Adm. Code 130.1935(a)(1) are not met. (This is a GIL.)

June 19, 2013

Dear:

This letter is in response to your letter dated May 22, 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 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:

> COMPANY is a reseller of software such as SOFTWARE1, SOFTWARE2, SOFTWARE3 & others. We are strictly a reseller and in no way do we modify the software that we purchase and sell. Our software sales are on a license basis and therefore fall within Illinois Department of Revenue Code 130.1935 – sales of software licenses. Our understanding is that sales that meet the five prong test laid out in the code are exempt from sales tax.
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> The following are the tests to determine taxability: a) a written agreement between the software licensor and the customer, b) restriction on the customer's duplication and use of the software, c) prohibitions on the customer from licensing, sublicensing or transferring the software to a third party, d) the licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software or of 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 under penalties of perjury by the licensor; and the vendor will provide another copy at minimal or no charge if the customer lose or damages the software, and e) the customer must destroy or return all copies of the software to the vendor at the end of the license period.
>
> COMPANY is a reseller of software and is NOT the licensor. We do NOT have a written agreement between our customer and COMPANY for each license sold to them. Because of that fact, test (a) is not met. Therefore we do not believe that the transactions between COMPANY and our customers are tax exempt.
>
> We have been approached by numerous of our customers indicating that they believe that we should NOT be charging them sales tax because they have a licensing

agreement between the licensor (SOFTWARE1) and themselves and therefore they should not be charged sales tax by COMPANY.

We have called the Illinois Department of Revenue as have some of our customers and we each seem to get slightly different messages. As such, I have been compelled to write this to Legal Services in order to obtain a General Information Letter clarifying the position that we should be taking.

As such, please clarify the tax code 130.1935, indicating whether sales by a reseller of software who is not the licensor should be exempt from sales tax or whether those sales are subject to charging sales tax.

To clarify the facts one more time:

- COMPANY is a reseller of software;
- COMPANY does not change or modify the software in any way;
- The software that is sold is licensed between the publisher (not COMPANY) and our customers;
- COMPANY does NOT have a license agreement between ourselves and our customers;
- Our customers DO have license agreements between themselves and the software publishers.

Please clarify whether we (COMPANY, the reseller) should be charging sales tax to our customers on the sale of software or not.

DEPARTMENT'S RESPONSE:

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. The tax is measured by the seller's gross receipts from retail sales made in the course of such business. "Gross receipts" means the total selling price or the amount of such sales. The retailer must pay Retailers' Occupation Tax to the Department based upon its gross receipts, or actual amount received, from the sale of the tangible personal property.

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 transactions for the licensing of computer software meet all of the criteria provided in subsection (a)(1) of Section 130.1935, 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.

A license of canned software is subject to Retailers' Occupation Tax liability if all of the criteria set out in 86 Ill. Adm. Code 130.1935(a)(1) are not met.

In your letter you indicate that your customers have entered into licensing agreements directly with the companies that write the computer software and sell it to you for resale. If the licensing agreement between the companies that write the computer software and your customers meet the requirements of Section 130.1935(a)(1), neither the transfer of the software by you to your customers nor the subsequent software updates will be subject to Retailers' Occupation Tax. However, at or before the time of sale, you must obtain for your records a copy of the signed licensing agreement from each of your customers to document these exempt sales.

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