

ST-13-0058-GIL 10/18/13 SERVICE OCCUPATION TAX

If no tangible personal property is transferred to the customer, then no Illinois Retailers' Occupation Tax or Service Occupation Tax would apply. See 86 Ill. Adm. Code Parts 130 and 140. (This is a GIL.)

October 18, 2013

Dear Xxxxx:

This letter is in response to your letter dated September 3, 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:

We are requesting technical assistance on an anonymous basis for a company ('Company') with operations in the state of Illinois. Please find below the Company description and technical questions regarding the appropriate application of the state of Illinois sales tax law.

Attached is a list of revenue categories with descriptions for which we are requesting technical advice as to the category's taxability. All revenue categories are separately stated on customer invoices.

Company Description:

1. The Company is a leading national provider of lifecycle records and information management solutions. The Company provides document storage, data protection, digital/electronic document management and certified destruction. The Company offers digital document management solutions with the integration of traditional or legacy hard copy storage, supplying its customers with an integrated platform of services and information management solutions. The Company does [sic]ngage in the self-storage business.

Products and Services

2. The Company offers the following Products and Services to its customers. Please find attached a **Revenue Category Matrix** for detail descriptions of revenue categories for which we are seeking assistance and a description of the activities. The following is a list of the Company's Products and Services:

a. TPP

- i. Sales
- ii. Rentals
- iii. Maintenance

b. Storage

- i. Physical Storage
- ii. Physical Storage – Specialty
- iii. Perm-Out of Customer Accounts

c. Warehouse Services

- i. Account Maintenance Fees – AMF Document Storage
- ii. Account Maintenance Fees – AMF Vault Storage
- iii. Access/Re-file Fees
- iv. Pick Up and Delivery Fees
- v. Weekend Pick Up and Delivery Fees
- vi. Minimum Pick Up and Delivery Fees
- vii. Minimum Storage Billing Fees
- viii. Emergency Service – Rush or Expedite Fees
- ix. Fuel Surcharge
- x. Access Viewing Room use
- xi. Release of Information (ROI) – Physical Delivery Method
- xii. Release of Information (ROI) – Electronic Delivery Method
- xiii. Standard Shredding/Destruction
- xiv. Certified Shredding/Destruction

d. Digital Services

- i. Digital Imaging, Scanning and Conversion
- ii. Account Maintenance Fees – AMF Imaging
- iii. License Fees for Online Access to Virtual Warehouse
- iv. License Fees for Workflow Automation Software
- v. Hosting Fees for Virtual Warehouse Software
- vi. Online Information Service/Research Tool
- vii. License fee for Online Research Tool
- viii. Electronic Back-up Services
- ix. Online Data Storage Fees

e. Personnel Services

- i. Online Support Help Desk

- ii. Fees for Digital Upload of Client Records or Files Electronically
- iii. Service Fees for Data Entry/Indexing
- iv. Virtual Warehouse Set-up and Configuration

f. Cancellation Charges

We appreciate your assistance with these technical questions. If you have any questions or require any additional information please contact me via email or by phone at (XXX) XXX-XXXX.

Your attachment asks whether the following items are taxable or tax exempt and reads, in part, as follows:

| <u>Item</u> | <u>Revenue Category</u> | <u>Description of Revenue Category</u> |
|-------------|----------------------------------|--|
| 1 | <i>TPP</i> | Sale, Rental, or Maintenance of Tangible Personal Property |
| | Sales | Sale of supplies to customers to store materials including but not limited to: boxes, folders, containers, tapes, CD, encrypted hard drives, etc. |
| | Rentals | Rentals of containers, computer scanners, and other computer hardware. |
| | Maintenance | Maintenance contracts for equipment rentals of computer scanners and other computer hardware. |
| 2 | <i>Storage</i> | Fees for Physical Storage of TPP |
| | Physical Storage | Physical storage of customer materials which include documents, books, manuscripts, and electronic data stored on a physical media such as tape or CD, within a controlled environment with limited direct access by the customer. |
| | Physical Storage - Specialty | Physical storage of customer materials including: Art, Antiques, Artifacts, Wine, and Spirits within a secure climate controlled facility with limited direct access by the customer. |
| | Perm-Out of Customer Accounts | Fee charged for cancellation of a customer's physical storage contract |
| 3 | <i>Warehouse Services</i> | Fees for Additional Services Provided by |

Company to its Customers

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|--|---|
| Account Maintenance Fees (“AMF”): AMF Document Storage | AMF Document Storage are recurring account maintenance fees for document storage-Administrative Fee |
| Account Maintenance Fees (“AMF”): AMF Vault Storage | AMF Vault Storage are recurring account maintenance fees charged for large storage rooms are only accessed by Company personnel and not by the customers directly.- Administration Fee |
| Access/Re-file Fees | Service to retrieve and/or replace customer materials are separately stated and consist of charges for accessing and refilling storage containers. |
| Pick Up and Delivery Fees | Service to pick up and/or deliver customer materials to and from customer locations are separately stated as pick up and delivery. |
| Weekend Pick Up and Delivery Fees | Weekend service to pick up and/or deliver customer materials to and from customer locations are separately stated as pick up and delivery. |
| Minimum Pick Up and Delivery Fees | Fee for service to pick up and/or deliver customer materials to and from customer locations are separately stated as pick up and delivery. |
| Minimum Storage Billing Fees | Fees charged at 75% of the client’s stated allocation projected inventory balance. |
| Emergency Service - Rush or Expedite Fees | Emergency or Rush service to pickup and/or deliver customer materials to and from customer locations are separately stated and consist of charges for pickup and delivery on a rush or expedited basis. |
| Fuel Surcharge | Fees to pass on incremental increases in the price of fuel used in the pick up and delivery of customer materials. |
| Access Viewing Room Use | Fees for use of a room for review of customer material. |

Release of Information Services (ROI) – Physical Delivery Method
Fees for the retrieval, duplication and delivery of certain medical information to a third-party other than the customer. This sensitive medical information is required by most states to be handled and delivered in a secure manner. The Company may deliver these records to the third-party via physical delivery.

Release of Information Services (ROI) - Electronic Delivery Method
Fees for the retrieval, duplication and delivery of certain medical information to a third-party other than the customer. This sensitive medical information is required by most states to be handled and delivered in a secure manner. The Company may deliver these records to the third-party via digital delivery electronically via the internet.

Standard Shredding/ Destruction
Bonded driver picks up materials to be destroyed and returns the items to the Company owned secure warehouse. Company processes and destroys the materials by placing in a machine for destruction, treating them with chemicals and dissolving or pulverizing to a heavy liquid mass.

Certified Shredding/ Destruction
Bonded driver picks up materials to be destroyed and returns the items to the Company owned secure warehouse. These materials are then combined with others and transported to a third-party vendor for destruction. The company in return receives a Certificate of Destruction upon the destruction of all materials.

4 *Digital Services*

Electronic document management, scanning, and storage solutions. Services are billed on a per occurrence or monthly basis.

Digital Imaging/ Scanning/Conversion
Conversion of customer materials to digital images by means of digital scanning.

Account Maintenance Fees – AMF Imaging
Recurring account maintenance fees for customers with monthly imaging/scanning accounts. – Administration Fee.

License Fees For
License fees charged on a per user basis to

| | |
|--|--|
| Online Access to Virtual Warehouse | access digital images stored in customer's virtual warehouse |
| License Fees for Workflow Automation Software | License fees charged on a per user basis to access and utilize the Workflow Automation Software which permits a customer to scan a document and track its movement through various departments. For example, in the case of an invoice in Accounts Payable: (1) customer receives an invoice, the invoice is scanned, (2) it is then electronically routed to the applicable department(s) for approval, (3) once approved the invoice is electronically routed back to accounts payable to be approved for payment. |
| Hosting Fees for Virtual Warehouse Software | Fees to customer for hosting Virtual Warehouse Software on the cloud which is used for Work Flow Automation and Online Record Storage |
| Online Research Tool - Regulatory Rules and Regulation Directory | Fees charged on a per user basis to access an on-line repository of document retention and destruction guidelines by State and by discipline. |
| Electronic Back-Up Services | Fees charges for 24/7 electronic back-up services. Customer data is backed up via the internet and is stored on a remote server for emergency data recovery needs. Company uses a third-party vendor to perform this service. |
| Online Data Storage Fees | Fees for online record storage which are based on the amount of virtual warehouse storage the customer requires. This service is based upon an outsourced, cloud-based platform and web-based on-demand software. Fees are charged on the amount of storage purchased. |
| 5 Professional Services | Professional Services provided by Company staff as Support, Design or Configuration Services to customers |
| Online Support Help Desk | Customer telephone help desk to address issues users may have with online services. |
| Fees for Digital Upload of Client | Upload fee is charged when a customer types data or exports data to a file which is provided |

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|--|--|
| Records or Files Electronically | to Company for 'upload' to the digital warehouse. |
| Data Entry/ Indexing | Fees for services related to data entry and the indexing of information previously scanned to allow for future search or query abilities. |
| Virtual Warehouse Set-Up and Configuration | Technical fees for setting up a customer with the virtual warehouse including the online storage of customer files which the customer may later access remotely online. Designing, programming, and customization of third-party software to meet specific customer needs. |

6. Cancellation Charges Charge for Cancelling any Revenue Category

Fees for the cancellation of a revenue category as per the customer's instructions.

DEPARTMENT'S RESPONSE:

The Department generally does not complete surveys or matrices. We advise you to consult Illinois statutes and administrative rules as well as Department publications on these matters. However, we hope the following information will provide sufficient guidance to answer your questions.

Tangible Personal Property

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* 35 ILCS 120/2; 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* 35 ILCS 105/3; 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois. If the purchases occur in Illinois, the purchasers must pay the Use Tax to the retailer at the time of purchase. The retailers are then allowed to retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales. If the purchases occur outside Illinois, purchasers must self assess their Use Tax liability and remit it directly to the Department.

Retailers' Occupation and Use Taxes do not apply to sales of service. The Service Occupation Tax Act and Service Use Tax are imposed on the transfer of tangible personal property incident to sales of service. *See* 86 Ill. Adm. Code 140.101 and 160.101. If the transactions you are inquiring about do not involve the transfer of any tangible personal property

to the customer, then they generally would not be subject to Retailers' Occupation Tax, Use Tax, Service Occupation Tax, or Service Use Tax.

The State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases. A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if a lessor is guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction. Persons who purchase items for resale under conditional sales contracts can avoid paying tax to suppliers by providing certificates of resale that contain all the information set forth in 86 Ill. Adm. Code 130.1405. All receipts received by a lessor/retailer under a conditional sales contract are subject to Retailers' Occupation Tax. *See* 86 Ill. Adm. Code 130.2010.

A true lease generally has no buy out provision at the close of the lease. If a buy-out provision exists, it must be a fair market value buy-out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. *See* 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property.

The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability. As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. *See* subsection (a)(3) of 86 Ill. Adm. Code 150.310.

Under Illinois law, lessors may not "pass through" their tax obligation to lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where the lessees agree to reimburse the lessors for the amount of tax paid, then the lessees are obligated

The taxability of maintenance agreements or extended warranties depends upon whether the charges for the agreements are included in the selling price of the tangible personal property. *See* Ill. Adm. Code 140.301(b)(3). 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. No tax is incurred on the maintenance services or parts when the repair or servicing is performed.

If maintenance contracts are sold separately from tangible personal property, sales of the contracts are not taxable transactions. However, 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). Purchasers of separate maintenance agreements are not charged tax on the labor or tangible personal property that is transferred incident to the completion of the maintenance contract.

Warehouse Services

Illinois Retailers' Occupation Tax is imposed upon gross receipts from the sale of tangible personal property to end-users, and gross receipts is defined to mean all the consideration received by sellers valued in money whether received in money or otherwise, but not including the value of or credits given for like kind traded-in property. In computing Retailers' Occupation Tax liability, no deductions shall be taken by a taxpayer from gross receipts on account of the cost of the property sold, the cost of materials used, labor costs, or any other expense whatsoever. *See* 86 Ill. Adm. Code 130.410.

In the context of selling storage services, the fuel surcharges are costs of doing business subject to the tax. The question of whether delivery fees or charges may be deducted by retailers in calculating Retailers' Occupation Tax liability depends not upon the separate billing of such delivery charges but upon whether the charges are included in the selling prices of the property or are agreed to by purchasers and retailers separately from the selling price of the property.

If a seller delivers the tangible personal property to the buyer, and the seller and the buyer agree upon the transportation or delivery charges separately from the selling price of the tangible personal property which is sold, then the cost of the transportation or delivery service is not a part of the "selling price" of the tangible personal property which is sold, but instead is a service charge, separately contracted for, and need not be included in the figure upon which the seller computes his or her tax liability. *See* 86 Ill. Adm. Code 130.415(d).

A separate listing on an invoice of such charges is not sufficient to demonstrate a separate agreement. The best evidence that transportation or delivery charges were agreed to separately and apart from the selling price is a separate and distinct contract for transportation or delivery. However, documentation which demonstrates that the purchaser had the option of taking delivery of the property, at the seller's location, for the agreed purchase price, or having delivery made by the seller for the agreed purchase price, plus an ascertained or ascertainable delivery charge, will suffice. Note, as stated in Section 130.415 of the Department's regulations, if the charges for transportation or delivery exceed the cost of delivery or transportation, the excess amount is subject to tax. For further information, see *Nancy Kean v. Wal-Mart Stores, Inc.*, 235 Ill. 2d 351, 919 N.E.2d 926 (2009).

Storage and Shredding

The tax liabilities of warehousemen who hold themselves out to the public as being engaged in the business of moving, storing, packing and shipping tangible personal property belonging to other persons are generally engaged in a service transaction. *See* 86 Ill. Adm. Code 130.2170. The business of providing security, shredding and storage services would generally fall under this category. Again, if no tangible personal property is transferred to the service customer, then no Retailers' Occupation Tax, Use Tax, Service Occupation Tax, or Service Use

Tax, is incurred. Retailers' Occupation Tax liability may be incurred on any shredded material that is sold to a third party. Such a transaction may be exempt from tax if the purchaser is making a purchase of the shredded material for resale. *See* 86 Ill. Adm. Code 130.1405.

Use Tax liability would be incurred on equipment and materials used in Illinois in the performance of the service transaction. Some equipment, such as the shredder and balers, may qualify for the manufacturing machinery and equipment exemption. *See* 86 Ill. Adm. Code 130.330 and general information letter ST-03-0117-GIL.

Digital Services

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. *See* 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.

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 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 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.

Telecommunications

Telecommunications services are not taxable under Illinois' sales and use taxes. For information regarding the Illinois Telecommunications Excise Tax, we refer you to the

Telecommunications Excise Tax Act, which is set forth at 35 ILCS 630/1 et seq. The Department's regulations for this tax are found at 86 Ill. Adm. Code Part 495. The Telecommunications Excise Tax is imposed upon the act or privilege of originating or receiving intrastate or interstate telecommunications in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers. *See* 35 ILCS Sections 630/3 and 630/4. Telecommunications retailers collect tax from end users and remit it to the Department. *See* 86 Ill. Adm. Code 495.140. If a retailer only charges for the search and downloading of information, and does not charge for the telecommunications transmission, then those transactions are not subject to Telecommunications Excise Tax and Simplified Municipal Telecommunications Tax liability. *See* 35 ILCS 630/1 et seq. and 35 ILCS 636/5-1 et seq. Should a retailer charge customers for transmission or telephone line charges, then the above-mentioned telecommunications taxes would apply. Charges for data processing and information retrieval are not subject to telecommunications taxes. *See* 86 Ill. Adm. Code 495.100(c). If retailers provide both transmission (such as telephone line charges) and data processing services, the charges for each must be separately stated and identified in the books and records of the retailers. If such charges are not separately stated in this manner, then all charges are taxable.

Cancellation Charges

A cancellation fee typically does not involve retail sales or the sale or transfer of tangible personal property incident to a sale of service. Such charges are not 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,

Cara Bishop
Associate Counsel

CB:msk