

ST 14-0052-GIL 12/18/2014 COMPUTER SOFTWARE

This letter discusses the taxability of computer software licenses. See 86 Ill. Adm. Code 130.1935.

December 18, 2014

Dear XXXX :

This letter is in response to your letter September 12, 2015, 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:

We are sending this request for a determination of whether our COMPANY Software License Agreement (“Agreement”) is exempt from the Retailers’ Occupation Tax (“ROT”) and issuance of a Private Letter Ruling (“PLR”) based on that determination. We have reviewed Illinois Regulation Sec 130.1935, and believe the software licenses we grant pursuant to these Agreements are exempt from application of the ROT.

This PLR is not requested for hypothetical or proposed transactions but is requested to determine the ROT consequences of the actual business practices of COMPANY (“COMPANY”). Accordingly, COMPANY respectfully requests the Department of Revenue issue a PLR pursuant to 2 Ill. Adm. Code 1200.110 with respect to the following factual information as required by 2 Ill. Adm. Code 1200.110(b)1.

**Statement of Facts**

COMPANY, is an Illinois corporation, with principal offices located at LOCATION, Illinois, engaged in the business of developing and licensing software to assist banks, credit unions and other financial institutions in forecasting, budgeting, asset management and planning.

Enclosed please find a copy of our standard Agreement wherein we are the licensor and our financial institution customers are the licensee/customer. Our licensing arrangement as reflected in the Agreement meets the five requirements necessary to qualify for exemption from the IL ROT as stated in IL Regulations, Sec. 130.1935(a)(1) namely:

- 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).
- D. The vendor will provide another copy at minimal or no charge if the customer loses or damages the software. [sic] 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 not aware of, nor have we been able to locate, any authority contrary to our view.

### ***Issues***

1) If *COMPANY* software is licensed as 'canned' software and *COMPANY*'s Agreement meets all the requirements in Sec. 130.1935(a)(1), parts A through E, then is *COMPANY*'s transaction subject to ROT? Stated another way, is the exemption from ROT as described in Sec. 130.1935(a)(1) only available for 'custom' software or does it also apply to 'canned' software that meets the Sec. 130.1935(a)(1) requirements?

2) If *COMPANY* software as licensed is considered "custom" software and *COMPANY*'s Agreement meets all the requirements in Sec. 130.1935(a)(1), parts A through E, then is *COMPANY*'s transaction subject to ROT? Stated another way, is the exemption from ROT described in Sec. 130.1935(a)(1) only available for 'custom' software or does it also apply to 'canned' software that has been customized to the specifications of a customer and that meets the Sec. 130.1935(a)(1) requirements?

We request a PLR to resolve the tax issues with our customers who have objected to paying *COMPANY* for sales tax we have billed to them. *COMPANY* has routinely submitted ROT to the Illinois Department of Revenue, *COMPANY* is not to its best belief and understanding subject to or under an audit or pending litigation with the Illinois Department and all of the foregoing is true and correct. To the best of our knowledge, the department has not previously ruled on the same issue for *COMPANY*. *COMPANY* considers the attached Agreement to be trade secret information and we request that this information be deleted from the publicly disseminated version of the PLR.

We would appreciate Illinois Legal Counsel's acceleration of a response to this request for a PLR so we can resolve this outstanding tax issue as soon as possible [sic]

If you have any questions or need to further information, please contact us. Thank you for your prompt attention to our request.

## **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. 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.

If computer software, including canned software, is licensed and the license agreement meets all of the criteria in subsection (a)(1) of Section 130.1935, the license of the software is not a taxable retail sale. In addition, if the computer software is custom software, as provided in subsection (c) of Section 130.1935, it is exempt from tax under the Retailers' Occupation Tax Act, Use Tax, Service Occupation Tax, and Service Use Tax.

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,

Samuel J. Moore  
Associate Counsel

SJM:lkm