

ST 16-0035-GIL 08/17/16 COMPUTER SOFTWARE

A provider of software as a service is acting as a serviceman. If the provider does not transfer any tangible personal property to the customer, then the transaction generally would not be subject to Retailers' Occupation Tax, Use Tax, Service Occupation Tax, or Service Use Tax. If the provider transfers to the customer an API, applet, desktop agent, or a remote access agent to enable the customer to access the provider's network and services, it appears the subscriber is receiving computer software that is subject to tax. See 86 Ill. Adm. Code Parts 130 and 140. (This is a GIL.)

August 17, 2016

RE: COMPANY

Dear Xxxxx:

This letter is in response to your letter dated September 22, 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.

In your letter you have stated and made inquiry as follows:

I am the authorized representative for the above-named taxpayer and am writing on its behalf to request a private letter ruling on tax reporting instructions and tax liability pursuant to Illinois Administrative Code Title 02, Part 1200, Section 200.110.

The issue the taxpayer requests the Department address is whether its services are subject to the Illinois Retailer's [sic] Occupation Tax or the Illinois Use Tax.

Pursuant to Section 1200.110, the taxpayer provides the following information.

**Statement of the facts and other information**

COMPANY is a software as a service company based in CITY, STATE. COMPANY offers on a subscription basis web-based software tools for marketing, analytics, and search engine optimization (SEO).

PRODUCT is a set of research and analytics tools that help increase search engine visibility. A single price subscription to PRODUCT includes the following software tools:

- TOOL 1 measures and improves website traffic, keyword rankings, and visibility. This program automatically audits the user's website, tracks rankings and link metrics, provides industry comparisons, and highlights useful and actionable insights.
- TOOL 2 identifies content and link building opportunities. This tool also researches and compares competitor backlinks, identifies top pages, views social activity data, and analyzes anchor text.
- TOOL 3 performs keyword research and page analysis from inside Chrome and Firefox browsers. It includes TOOL 4 metrics and social data to help users evaluate the popularity of the pages they visit.
- TOOL 5 searches, segments, and compares Twitter users, and tracks follower growth.
- TOOL 6 finds new link building opportunities and monitors the internet for mentions of the user's brand, products, and competitors.
- TOOL 7 produces reports on where pages or domains rank in search engines for any given keyword.
- TOOL 8 measures how difficult it is to rank for a specific term or phrase and competitors who may be using those same terms or phrases.
- TOOL 9 provides recommendations on page keyword usage with the goal of ranking higher and optimizing targeted search terms.
- TOOL 10 produces a site audit of up to ### pages against any public domain and finds bad links, broken pages, and analyzes ## factors that may affect search engine crawlability.

TOOL 11 is a software tool that allows users to manage business listings for accuracy. Since the internet acts as the equivalent of the modern yellow pages, this software tool sends user location data by geographic location to major data aggregators, which allows search engines to find specific and separate locations. For example, a brick and mortar retailer would use this tool to enter their different store locations, so local searchers will show locations closest to the device searching for information.

No tangible personal property is transferred to the user as part of using any of the COMPANY's web-based software tools.

COMPANY is not registered with the Illinois Department of Revenue. It has no employees or property in the state; it does not accept purchase orders in the state; it does not maintain inventory in the state; and it does not maintain a place of business in

the state as described in 86 Ill. Adm. Code 150.201. However, COMPANY is considering hiring an Illinois resident employee in the future.

### **Contracts, licenses, agreements, and other documents relevant to the request**

A copy of COMPANY's terms of use of its web-based software tools is attached.

### **Identification of the tax periods at issue**

COMPANY has no nexus with Illinois and is considering hiring an Illinois resident employee in the future. Therefore, this private letter ruling would be prospective only. No audit or litigation is pending with the Department.

### **Previous rulings by the Department to the taxpayer**

To the best of the knowledge of both COMPANY and COMPANY's representative, the Department has not previously ruled on the same or a similar issue for COMPANY or a predecessor, and COMPANY or any of its representatives have not previously submitted the same or a similar issue to the Department but withdrawn it before a letter ruling was issued.

### **Statement of authorities supporting the taxpayer's views**

COMPANY believes that its web-based software services are not subject to either the Illinois Retailer's [sic] Occupation Tax or the Illinois Use Tax, as no tangible personal property is transferred as part of the service. The Department has issued several General Information Letters that support COMPANY's views.

In ST-07-0068-GIL, the question was whether an electronically downloaded book was subject to the sales tax. The Department noted:

You are correct that information or data that is electronically downloaded is not considered the transfer of tangible personal property in this State. See 86 Ill. Adm. Code 130.2105(a)(3). Please note that canned computer software is considered 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.

It is our understanding that the electronic downloading of a book involves only the transfer of data or information and does not involve the electronic transfer of computer software. In such instances, the electronic download of a book is not subject to Retailers' Occupation Tax or Use Tax liability in this State.

Similarly, in ST 13-0074-GIL the Department noted that web-based software was not subject to Telecommunications Excise Tax, but also noted regarding the sales tax:

Note, in Illinois, information or data that is electronically transferred or downloaded is not considered the transfer of tangible personal property in this State. See 86 Ill. Adm. Code 130.2105(a)(3). However, 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.

And recently, in ST 15-0053-GIL the taxpayer provided a variety of web-based software tools. The Department noted:

Retailers' Occupation and Use Taxes do not apply to sales of service. The transactions you have described appear to be service transactions. Under the Service Occupation Tax Act, businesses providing services, (i.e. servicemen) are taxed on tangible personal property transferred as an incident to sales of service...

...the Department does not consider the viewing, downloading or electronically transmitting of video, text and other data over the internet to be the transfer of tangible personal property. However, if a company provides services that are accompanied with the transfer of tangible personal property (e.g., intuitive usage reports delivered to a customer in a hardcopy version, rather than sent electronically), such service transactions are generally subject to tax liability....

### **Statement of authorities contrary to the taxpayer's views**

COMPANY cannot locate any authorities contrary to the taxpayer's view.

### **Identification of trade secret information to be deleted**

This private letter ruling request contains no trade secret information that would be required to be deleted from any publically disseminated version of any ruling.

### **Properly executed power of attorney**

A copy is attached.

If you have any questions regarding the above matter or need additional information, please do hesitate to contact me at ##### or YYY@PERSON.com.

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

The Department's regulation "Public Information, Rulemaking and Organization" provides that "[w]hether to issue a private letter ruling in response to a letter ruling request is within the discretion of the Department. The Department will respond to all requests for private letter rulings either by issuance of a ruling or by a letter explaining that the request for ruling will not be honored." 2 Ill. Adm.

Code 1200.110(a)(4). The Department recently met and determined that it would decline to issue a Private Letter Ruling in response to your request. We hope, however, the following General Information Letter will be helpful in addressing your question.

### Sales Tax:

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.

### Service Transactions:

Retailers' Occupation Tax and Use Tax do not apply to sales of service. Under the Service Occupation Tax Act, businesses providing services (*i.e.*, servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. The serviceman's liability may be calculated in one of four ways:

- (1) separately-stated selling price of tangible personal property transferred incident to service;
- (2) 50% of the serviceman's entire bill;
- (3) Service Occupation Tax on the serviceman's cost price if the serviceman is a registered de minimis serviceman; or
- (4) Use Tax on the serviceman's cost price if the serviceman is de minimis and is not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

The Department does not consider the viewing, downloading or electronically transmitting of video, text and other data over the internet to be the transfer of tangible personal property. However, if a company provides services that are accompanied with the transfer of tangible personal property, including computer software, such service transactions are generally subject to tax liability under one of the four methods set forth above.

If a transaction does not involve the transfer of any tangible personal property to the customer, then it generally would not be subject to Retailers' Occupation Tax, Use Tax, Service Occupation Tax, or Service Use Tax.

## Computer Software

“Computer software’ means a set of statements, data, or instructions to be used directly or indirectly in a computer in order to bring about a certain result in any form in which those statements, data, or instructions may be embodied, transmitted, or fixed, by any method now known or hereafter developed, regardless of whether the statements, data, or instructions are capable of being perceived by or communicated to humans, and includes prewritten or canned software.” 35 ILCS 120/2-25. 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. 86 Ill. Adm. Code 130.1935. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. 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 86 Ill. Adm. Code 130.1935(c)(3). Computer software that is not custom software is considered to be canned computer software.

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 a license of canned computer software does not meet all the criteria the software is taxable.

It appears from your letter that the Company is making sales of service and is a serviceman. As a serviceman, the Company does not incur Retailers’ Occupation Tax. Service Occupation Tax is imposed upon all persons engaged in the business of making sales of service on all tangible personal property transferred incident to a sale of service, including computer software (35 ILCS 115/3), and is calculated as explained above. Currently, computer software provided through a cloud-based

delivery system – a system in which computer software is never downloaded onto a client's computer and is only accessed remotely – is not subject to tax. The Department continues to review cloud-based arrangements. If, after review, the Department determines that these transactions are subject to tax, it will only apply this determination prospectively.

You state in your letter that a subscriber of the service the Company provides does not receive any tangible personal property or download any computer software. However, the Terms of Service and your follow-up emails seem to indicate that the subscriber receives a downloadable toolbar and application program interface (API) as part of the service. Computer software is defined broadly in the Retailers' Occupation Tax Act. If a provider of a service provides to the subscriber an API, applet, desktop agent, or a remote access agent to enable the subscriber to access the provider's network and services, it appears the subscriber is receiving computer software. Although there may not be a separate charge to the subscriber for the computer software, it is nonetheless subject to tax, unless the transfer qualifies as a non-taxable license of computer software. If the provider, as a serviceman, is not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act and qualifies as a de minimis serviceman, the provider could elect to pay Use Tax on its cost price of the computer software.

I hope this information is helpful. If you have further questions related to the Illinois sales tax laws, 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

RSW:bkl