ST 17-0038-GIL 12/28/2017 COMPUTER SOFTWARE

This letter discusses the taxability of computer software. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

December 28, 2017

Dear Xxxxx:

This letter is in response to your letter dated August 23, 2017, in which you requested 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 writing to obtain clarification and a ruling on the sales tax we have been charging on our sales to clients.
>
> We sell SAP Software Perpetual Licenses, as well as annual maintenance fees on that software, to our clients. The SAP software is sold with perpetual licenses to use the software. All purchases differ as each client can choose different products or licenses within the SAP Software World. The SAP Software can be configured for different uses and or customized but it is not considered custom software. Our client is the end user of the software.
>
> We have been charging State Sales Tax on the software licenses as well as the annual maintenance fees as they include software updates, and would like confirmation this is correct as our initial understanding is that this would be "canned software" and therefore taxable.
>
> We have been questioned if this is taxable due to the exemption criteria in the section under Computer Software that states the following and the 5 points are met through our sales process;
>
> "*If a transaction for the licensing of computer software meets all of the criteria provided in Section 130.1935(a)(1), 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."

We have been provided with the following ruling, but it is not clear if this is applicable to our situation, http://tax.illinois.gov/LegalInformation/LetterRulings/st/2012/ST-12-0022.pdf.

I have included a sample contract for your review and would be happy to discuss this further if any of the above is not clear or clarification is required.

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.

From the information provided, it is not clear exactly what the terms of the software license agreement are. If, however, the software license agreement consists of a written agreement signed by the licensor and the customer and otherwise meets the requirements of A through E above, then the license is not a taxable retail sale.

The General Information Letter you referenced in your request does not appear to apply to the situation described here because that letter deals with the taxability of a resale transaction and not a retail transaction as you describe here.

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,

Samuel J. Moore
Associate Counsel

SJM:bkl