ST 19-0006-GIL 03/06/2019 COMPUTER SOFTWARE

This letter discusses computer software. See 86 Ill. Adm. Code130.1935. (This is a GIL.)

March 6, 2019

Dear Xxxx

This letter is in response to your letter dated December 11, 2018 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:

> This month we discussed my company being charged sales tax by BUSINESS when we purchase the professional tax preparation software PRODUCT from them. That purchase being subject to Illinois sales tax made sense. Being charged sales tax by BUSINESS when I turn on "Rep" access is what I question. You emailed me on December 6th and stated that the issue I raise is highly dependent on the facts. I am sending you this letter to explain the facts.
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> Annually my company purchases a License from BUSINESS to use their professional income tax preparation software called PRODUCT. This License depending upon the number of States I select costs $$$ up. I can have the software shipped to me via a CD or download the software. I chose both methods and install the software on my local server and workstations. The server and workstations are located in CITY, IL. BUSINESS charges my company sales tax on this purchase. Which State they are charging us sales tax for is not identified but the invoice uses a rate of 6.25% so I am assuming it is IL Sales Tax. I think BUSINESS is handling this transaction correctly. BUSINESS sells this software to thousands of tax firms.
>
> When the PRODUCT software is ready I can download the code and install it on my workstations. At that time I have the option to download all the Federal and State modules that PRODUCT produces or a limited number. Generally I chose to download the Federal Individual, Fed Corporation, Fed Partnership Fed S-Corp, and the corresponding IL and STATE modules. I also download a number of individual modules for other States where my clients live. I have in the past downloaded the code for all of the States but have not done that in recent years.

The license I purchase allows me to prepare and file unlimited Federal, IL and STATE income tax returns for Individuals. It also provides me with "REP" access to PRODUCTS other income tax products. These products are Federal and State Business income tax returns. Like Corporations, Partnerships and S-Corporations. I can also access every State module that I may need. When I access any module other than the Federal 1040 individual, IL individual or STATE individual I am charged a REP access fee by BUSINESS.

When I prepare an income tax return that includes a module other the Federal, IL or STATE individual if that software module has already been downloaded I can enter the clients [sic] information into that module. If the module is not on my system I can download it online from BUSINESS. I am not charged a fee to download the software or to enter information into that module. When I want to view the forms on my computers display screen I apply to BUSINESS for Rep Access. When I am granted Rep Access I am charged a fee for using that module for that client. BUSINESS at that time also charges me Sales Tax on that REP access fee. Being charged a sales tax on that fee is what I question.

NAME in preparing this letter I printed out the BUSINESS Software End User License Agreement and IL Regulation Section 130.1935 on computer Software both of which I have enclosed. After reading the Regulation and the PRODUCT Software license I really am of the opinion that my PRODUCT License meets all the 5 items spelled out in the Regulation to exempt the License from Sale Tax. I contacted BUSINESS and asked about item A) a written agreement. I was told in this day and age that clicking on agree in the software really takes the place of a wet signature. I am not sure that the State of Illinois would agree but that is what I was told. So it is BUSINESS'S position that the agreement was signed.

So while my initial concern was being charged IL Sales Tax On REP charges by BUSINESS and it still is a concern of mine I think under the wording of this License agreement I really am not purchasing anything but merely paying for a License to use the PRODUCT software in which case based upon the regulations my payment for this software license would not be taxable retail sale.

I respectfully request that you review this information and see if I need to bring this to the attention of the State and Local tax folks at BUSINESS and seek a refund for Il Sales tax paid to them in error.

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. 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 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 reduce the amount of Use Tax they must remit by the amount of Retailers' Occupation Tax liability which they are required to and do pay to the Department with respect to the same sales. See 86 Ill. Adm. Code 150.130.

"'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.

In order to comply with the requirements as set out in Section 130.1935(a)(1), there must be a written "signed" agreement. A license agreement in which the customer electronically accepts the terms by clicking "I agree" does not comply with the requirement of a written agreement signed by the

licensor and customer. The Department recently decided an electronic license agreement in which the customer accepts the license by means of a signature in electronic form that is attached to or is part of the license, is verifiable, and can be authenticated will comply with the requirement of a written agreement signed by the licensor and customer. See ST-18-0010-PLR (Sept. 26, 2108) for examples of acceptable electronic signatures. A license agreement in which the customer electronically accepts the terms by clicking "I agree" remains unacceptable.

Computer software is defined broadly in the Retailers' Occupation Tax Act. However, software-as-a-service or 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. Please note, however, that if a provider of such 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, the subscriber is receiving computer software. Although there may not be a separate charge to the subscriber for the computer software, the serviceman transferring the computer software is nonetheless subject to tax, unless the transfer qualifies as a non-taxable license of computer software.

Based on the information you have provided, we are unable to determine whether the REP access you obtain on a pay-per-use basis to prepare and print off returns is computer software or is provided in a manner that is not taxable. We would need more information from BUSINESS describing how the REP access is provided to you.

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 or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Richard S. Wolters
Chairman, Private Letter Ruling Committee

RSW: rkn