ST 19-0009-GIL 04/29/2019 COMPUTER SOFTWARE

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

April 29, 2019

Dear Xxxx:

This letter is in response to your email dated April 24, 2019, 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:

> I am requesting a private letter ruling about the collection of Illinois sales tax by a company called COMPANY, based in CITY, STATE.
>
> Following is the information requested in Title 2 Part 1200 Section 1200.110 – Private Letter Rulings, part b), items 1-8.
>
> 1) *A complete statement of the facts and other information pertinent to the request.*
>
> COMPANY is a service-only business. The services that the company provides are the storage of my list of customers' email addresses and the distribution of my mass emailings to those customers. I use interactive forms on their web site to add and delete email addresses; to compose the messages for my mass emailings; and to schedule the dates and times for those mailings. At the scheduled time, the message is sent by the company to my customers.
>
> COMPANY does not sell tangible products of any kind, and they do not sell or license computer software of any kind. Because there is no transfer of any property of any kind from COMPANY to me, they should not be charging Illinois sales tax on their annual fee for their services.
>
> 2) *All contracts, licenses, agreements, instruments or other documents relevant to the request.*

I have attached a PDF file ("Website and Products Terms and Conditions of Use - COMPANY") containing their terms and conditions. When reading the company's Terms, it is important to note that their terminology can confuse and complicate the issue. Specifically, they repeatedly refer to their services as "products," which implies that they sell something tangible. In context, it becomes apparent that their "products" are nothing more than the interactive functions on their web site.

In Section 7.1 of their Terms and Conditions, COMPANY specifically states that they do not sell or license software. I have attached a file ("COMPANY Terms-Conditions Section 7.1") which isolates that pertinent section of their terms.

3) *An identification of the tax period at issue, and disclosure of whether an audit or litigation is pending with the Department…*

COMPANY has been charging sales tax to their Illinois customers since 20XX, and they have continued that practice to date. From December 3, 20XX, through September 28, 20XX, I have paid a grand total of $$$ in sales tax on my annual fees. I have attached a scan of my most recent invoice/receipt ("COMPANY-20XX-invoice"). Unfortunately, it does not itemize the amounts, but it is mathematically provable to be their current base rate of $$$ plus 6.25% sales tax ($$$).

I know of no audit or litigation pending with the Department.

4) *A statement that to the best of the knowledge of both the taxpayer and the taxpayer's representative the Department has not previously ruled on the same or a similar issue for the taxpayer or a predecessor…*

According to COMPANY, they did request Private Letter Rulings in 20XX and 20XX. They sent me the responses, which I have attached as "Illinois Private Letter Ruling-GIL.pdf" and "Rulings__Illinois-GIL__02_29_20XX.doc". In both cases, they received General Information Letters referring to the statutes regarding the sale and licensing of software, which COMPANY misinterpreted and misapplied.

In all discussions and conversations that I have had with the company, they refer to "Regulation Section 130.1935 of Title 86 of the Illinois Department of Revenue Regulations," a regulation which only applies to the sale and licensing of software. Again, that is not the nature of COMPANY'S business.

In addition to that, the company has cited the nexus rule, because they have an office in CITY, Illinois. However, the nexus rule is also irrelevant to the issue, because the company does not sell tangible products.

I requested a Private Letter Ruling myself in October 20XX, but I also received a GIL stating that the laws concerning sales of software were clearly stated and there was no need to issue a ruling on the matter. Unfortunately, that GIL didn't help me to convince COMPANY that they were misinterpreting the clearly stated laws.

5) *A statement of authorities supporting the taxpayer's views, an explanation of the grounds for that conclusion and the relevant authorities to support that conclusion.*

I have no authorities that I can name, but I have called and talked to people in the Department of Revenue three or four times through the years. Everyone agrees that services are not taxable, and a service-only business should not be collecting tax. Nobody disputes that, but I have not been able to find anyone who will instruct COMPANY to stop collecting taxes; and COMPANY won't take my word for it, of course.

6) *A statement of authorities contrary to the taxpayer's views. Each taxpayer is under an affirmative duty to identify any and all authorities contrary to the taxpayer's views. If the taxpayer determines that there are no authorities contrary to his or her views, or taxpayer is unable to locate such authority, the request must contain a statement to that effect.*

I know of no authorities who have views contrary to mine.

7) *An identification of any specific trade secret information taxpayer requests be deleted from the publicly disseminated version of the private letter ruling.*

There are no trade secrets contained here.

8) *The signature of the taxpayer or the taxpayer's representative…*

I am submitting this request via email. I hope that my electronic signature is sufficient.

I hope that the Department of Revenue can issue a private letter ruling stating that, as a service-only business, COMPANY has no obligation to collect sales tax from its Illinois customers and that it should stop doing so.

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.

A provider of software as a service is acting as a serviceman. As a serviceman, the seller 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). 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.

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, the subscriber may be 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.

Under the Service Occupation Tax Act, a serviceman is taxed on tangible personal property transferred incident to a sale of service. The transfer of tangible personal property to service customers may result in either Service Occupation Tax liability or Use Tax liability for servicemen, depending upon which tax base they choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

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 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,

Richard S Wolters
Associate Counsel

RSW:rkn