ST 19-0021-GIL 12/04/2019 COMPUTER SOFTWARE

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

December 4, 2019

Dear XXX:

This letter is in response to your letter dated June 17, 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:

> COMPANY ("Company") is conducting a review of its tax obligations with respect to one of its revenue streams. As taxability of software is evolving and product offerings are becoming more complex, Company seeks guidance as to whether it has an obligation to collect and remit Illinois Retailer's Occupation Tax ("ROT") or Service Occupation Tax ("SOT") on its revenue stream in question. Company wishes to seek formal guidance from the state of Illinois with respect to the proper classification and tax treatment of its offering.
>
> On behalf of Company and pursuant to Ill. Admin. Code tit. 2, § 1200.110, we respectfully submit this request for formal written and binding guidance from the Illinois Department of Revenue ("DOR") on the proper application of ROT and/or SOT pertaining to Company's offering.
>
> FACTS
>
> Company is a privately-owned financial services firm providing individuals and institutions with private banking, investment management and investor services.
>
> Company's revenue stream in question is PRODUCT. PRODUCT offers an enhanced communications platform ("PRODUCT") to its customers located in Illinois ("Users"). PRODUCT provides a single connectivity point between Users and their external service providers and internal systems. Data originates from the users and/or external service providers and is transmitted to Company via proprietary connections. In accordance with users' specific requirements, PRODUCT will normalize, translate, and

transform the information, which is then transmitted via proprietary connections. Included in the PRODUCT product offering are communications tools and consulting services. PRODUCT is an application only offering. Company does not co-mingle User data, and User data is not incorporated into reports furnished to other Users.

Given the breadth of Illinois' definition of what constitutes taxable computer software, and as a result of external guidance, Company began collecting Illinois ROT from PRODUCT customers in November 20XX. However, upon review of more recent guidance issued by the state[1] in March of this year, Company seeks formal clarification on the proper classification and taxability of its PRODUCT product.

Attached is a copy of the Communications Services Agreement ("Exhibit A") which provides a more exhaustive description of Company's PRODUCT product.

Further, highlighted in the agreement are the following provisions that assist in describing the purpose and functionality of PRODUCT to Users:

- *The PRODUCT services described herein are provided to User as an enhanced communications platform and not as replacement of the User's own communications media. PRODUCT is not a primary source of information. PRODUCT is a communications platform designed to communicate primary source information between User and User Approved Destinations.*[2]

- *To this end PRODUCT supplies: communications facilities, information management tools, and access to hosted website environment.*[3]

- *PRODUCT Materials – Shall mean certain materials supplied by Company to User in the course of performance of this Agreement, which may include (without limitation), business methodology, business plans, procedures, handbooks, software (in object code or source code form) necessary to operate and maintain the User Environment, data, documentation or information developed or provided by Company or suppliers.*[4]

RULING REQUEST

Company requests the Department's written and binding confirmation of the classification of PRODUCT and the applicability of the Illinois ROT and/or SOT to this offering.

Please do not hesitate to contact me at NUMBER or EMAIL with any questions or concerns.

DEPARTMENT'S RESPONSE:

[1] ST 19-0007-GIL 03/20/2019; ST 19-0006-GIL 03/06/2019.
[2] Exhibit A, Page 1.
[3] Exhibit A, Page 2.
[4] Exhibit A, Page 3.

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 due to the lack of information regarding the product contained in your request. We hope however, the following General Information Letter will be helpful in addressing your questions.

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

"'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 previously held that an electronic signature did not comply with the requirement of Section 130.1935(a)(1)(A) that the license be evidenced by a written agreement signed by the licensor and the customer. ST 06-0005-PLR (December 16, 2006). In ST 18-0003-PLR (February 8, 2018), the Department decided that 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 (September 26, 2018) for examples of acceptable written 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.

If an Illinois customer downloads computer software for free from an out-of-state retailer's web site or server that is also located out-of-state, the retailer, even though it is donating tangible personal property to the customer, has exercised no power or control over the property in Illinois. In this instance, the donor would not have made any taxable use of the property in Illinois. The customer, the donee, would incur no Use Tax liability for the retailer to collect and remit to Illinois. Illinois does not tax subscriptions.

Telecommunications

The Illinois Telecommunications Excise Tax Act imposes a tax on the act or privilege of originating or receiving intrastate or interstate telecommunications by persons in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers by such persons. 35 ILCS 630/3 and 4. The Simplified Municipal Telecommunications Tax Act allows municipalities to impose a tax on the act or privilege of originating in such municipality or receiving in such municipality intrastate or interstate telecommunications by persons in Illinois at a rate not to exceed 6% for municipalities with a population of less than 500,000, and at a rate not to exceed 7% for municipalities with a population of 500,000 or more, of the gross charges for such telecommunications purchased at retail from retailers by such persons. 35 ILCS 636/5-10 and 5-15.

The Act defines gross charges as including the amount paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by a retailer. 35 ILCS 630/2(a). The Act does exclude charges for customer equipment, including equipment that is leased or rented by the customer from any source, when those charges are disaggregated and separately identified from other charges. 35 ILCS 630/2(a)(4).

The gross charges for audio conferencing bridging services that include the reselling of telephone services are subject to the Telecommunications Excise Tax Act. When teleconferencing providers are reselling telephone services, they can provide resale certificates to the telephone service providers.

Generally, persons that provide services and who do not, as part of that service, charge customers for the line or other transmission charges that are used to obtain these services are not considered to be telecommunications retailers from these activities. Consequently, a company that provides audio conference services, for example, may pay its telecommunications provider the tax for telecommunications services it uses to provide the services. See ST 13-0048-GIL. If, however, the company separately charges customers for the line or other transmission charges, they should provide their telecommunications providers with Certificates of Resale and should themselves collect and remit tax. Some services may also be classified as value-added services and not subject to tax. See ST 15-0001-PLR.

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
Associate Attorney

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