

This letter discusses computer software. See 86 Ill. Adm. Code 130.1935(a)(1). (This is a GIL.)

October 6, 2020

Dear Xxxx:

This letter is in response to your letter dated December 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’m **requesting a private letter ruling** regarding whether any of the services our client provides to its Illinois customers are subject to the Illinois state and local sales and use tax. The following is a description of the services our client provides:

- **File Based Death Search (Death Check)**

We receive a file containing SSN, Name, DOB. We perform a death audit and return a file with data of death and match type.

- **Application Based Death Search (BDAS)**

Our customer leases software from us to perform a death audit. Lease term is yearly.

- **Online Death Search**

Customer can use our website to look up death records of individuals individually.

- **Death Appliance (IDAS)**

Customer leases a server from us where they can perform file based audits without requiring the customer to send us a file.

- **File Based Locator Service (Address Check)**

Customer sends us a file containing SSN, Name, and DOB and we return a set of possible addresses for the record.

- **Online Address Search**

Customer can perform individual address searches using our website.

- **Locator Service API**

Customer can call our web service from within their custom applications to validate addresses.

- **Custom Software Development**

We develop custom solutions for customers. Services are billed time and material.

I performed some research prior to sending this letter, including exchanging emails with the Illinois (IL) Department of Revenue (DOR). I'm enclosing a copy of my email exchanges with emails, it is **my understanding** that **none of our clients transactions are subject to the Illinois Retailers' Occupation Tax (sales tax) or the Illinois Use Tax**. However, in order to get an "official" response, I'm sending this letter and enclosure to **request a private letter ruling regarding the taxability of our client's services**.

Thank you for your assistance in this matter. If you have any questions or need additional information, please let me know.

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 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 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.

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 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.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of sales of service. They are required to collect the corresponding Service Use Tax from their customers.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See 86 Ill. Adm. Code 140.101(f). This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit tax to the Department by filing returns and do not pay tax to their suppliers. They provide suppliers with Certificates of Resale for the tangible personal property transferred to service customers.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of sales of service is less than 35% of the servicemen's annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess, and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See 86 Ill. Adm. Code 140.108.

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 is considered tangible personal property in Illinois. 35 ILCS 120/2-25. "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.

Computer software is defined broadly in the Retailers’ Occupation Tax Act. However, 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 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. Illinois generally does not tax subscriptions.

Leases

The State of Illinois taxes leases differently for Retailers’ Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases. A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if a lessor is guaranteed at the time of the lease that the leased property will be sold, that transaction is considered to be a conditional sale at the outset of the transaction. Persons who purchase items for resale under conditional sales contracts can avoid paying tax to suppliers by providing certificates of resale that contain all the information set forth in 86 Ill. Adm. Code 130.1405. All receipts received by a lessor/retailer under a conditional sales contract are subject to Retailers’ Occupation Tax. See 86 Ill. Adm. Code 130.2010.

A true lease generally has no buy out provision at the close of the lease. If a buy-out provision does exist, it must be a fair market value buy-out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors of a true lease owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability. In the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be allowed a credit against Use Tax to the extent of the amount of the tax properly due and paid in the other state. See 86 Ill. Adm. Code 150.310(a)(3).

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
Associate Counsel

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