ST 21-0001 01/15/2021 COMPUTER SOFTWARE

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

January 15, 2021

Dear Xxxx:

This letter is in response to your E-Mail dated May 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:

> It was nice speaking with you yesterday. As I mentioned, we are assisting one of our clients with determining whether the fleet management services they provide to customers in Illinois may be subject to the Illinois retailer's occupation tax, use tax, etc. As discussed, the following is a summary of the facts related to the fleet management service:
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> - Our client, who I will refer to as Company X, provides a web-based fleet management service for handling the administration, management, and record-keeping of motor vehicle fleets.
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> - Company X provides its services via a Software as a Service ("SaaS") model only. As you may know, "SaaS" allows a customer to remotely access a vendor's software applications on a cloud infrastructure; the customer does not manage or control the underlying cloud infrastructure. Under this model, the customer merely accesses the vendor's servers via the internet.
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> - In YEAR, Company X developed an application which it provides to its customers for free. Customers have the option of downloading the application to a personal device, such as a phone, tablet, etc., which the customer can use to more easily upload vehicle information necessary for fleet management; or it can continue to access the vendor's platform via the internet to transfer such information to Company X. Note the pricing of Company X's services did not change with the addition of the application.

- Company X does not provide the customer with the personal device, (i.e., tablet, phone, etc.) for use with the application, or any other tangible personal property.

- For example, a truck driver would use the application on his/her cell phone to upload information regarding fuel purchases, such as fuel cost, fuel quantity, or to keep track of mileage.

- Prior to the introduction of the application, a truck driver would keep a manual paper log of the same information and would turn the information into the office at the end of a trip for entry into the fleet management system.

- The user of the application on a personal device, can only enter information into the application when they are connected to the Internet. If the user is not connected to the Internet, they are not able to enter any information. In other words, the application that is downloaded to a personal device can only be used when the user has internet access on its device. However, it is anticipated that this functionality may change in the future, which will allow the user to enter information into the application which can be uploaded at a later time.

- It is important to note that the users of the application are typically the motor vehicle operators, who only have access to a portion of the platform for purposes of entering information.

- The individuals who use the fleet management software solution to manage the fleet, typically view the data through a web portal on their computers, but also have the ability to view the information on the app.

- The application is not necessary to the service provided by Company X, but practically speaking, most of Company X's customers avail themselves of the use of the application.

- The application does not have the capability for sending or receiving messages, such as communications with a dispatcher, etc. The application is solely used for uploading data related to fleet management (i.e., fuel, mileage, etc.).

- Company X is not registered for the Illinois retailer's occupation tax, use tax, etc.

As we understand, Illinois does not tax SaaS models, but it does tax electronically delivered software. Given our client's current business involves SaaS, but also has a free downloaded application available at the option of the customer, we recognize there is some uncertainty as to how to the State might characterize this transaction. Therefore, we would appreciate your guidance as to whether the fleet management service provided by our client would be subject to retailer's occupation tax, use tax, etc. We understand that your response to this request would not be binding upon the State.

Thank you again for your assistance with this matter. If you have any questions, please do not hesitate to call me.

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. 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 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 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 canned computer software.

If transactions for the licensing of computer software meet all 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.

Currently, 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 in Illinois. However, computer software is defined broadly in the Retailers' Occupation Tax Act. 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.

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.

The Department addressed this issue in a previous Private Letter Ruling, concluding the revenues received from subscriptions of a SaaS model web-based fleet management service are not subject to tax. The Department also concluded that an application downloaded for free by this service's subscribers from a server located in another state was not subject to tax for the reasons set out above. See ST-20-0004-PLR.

We cannot provide a more specific answer without more information about the specific products at issue. However, if the application is downloaded for free by the service's subscribers from a server located in another state, it would not be subject to tax. If the servers are not located in another state, the license of the software must meet all the criteria set out in Section 130.1935(a)(1); otherwise, it is taxable.

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,

Alexis K. Overstreet
Associate Counsel

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