ST-21-0008 11/23/2021 COMPUTER SOFTWARE

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

November 23, 2021

RE: COMPANY, Inc Private Letter Ruling

Dear NAME,

This letter is in response to your letter received September 29, 2021, 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.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY, for the issue or issues presented in this ruling, and is subject to the provisions of subsection (e) of Section 1200.110 governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither COMPANY, nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request. In your letter you have stated and made inquiry as follows:

> On behalf of COMPANY ("COMPANY" or the "Company"), we request the Illinois Department of Revenue (the "Department") issue a Private Letter Ruling ("PLR") with respect to the factual situation discussed below. This request is pursuant to 2 Ill. Admin. Code 1200.110. We request a ruling concerning the imposition and basis of the Illinois Service Occupation Tax ("SOT") to specific COMPANY transactions outlined below.
>
> **GENERAL INFORMATION**
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> 1. Enclosed is a copy of Power of Attorney Form IL-2848, executed by an authorized agent of the Company, authorizing CPA to act on the Company's behalf.
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> 2. This PLR request is not based on alternative plans of proposed transactions or a hypothetical situation, it is instead on the

Company's actual business as described below.

3. Neither the Company, nor any related taxpayer, is engaged in litigation with respect to this issue with the Department. The Company is not currently involved in any litigation in which the Department is a party.

4. The Company knows of no authority contrary to the authorities referred to and cited in this request.

5. To the best of the knowledge of both the Company and its representatives, the Department has not previously ruled on the same or similar issues for the Company; nor has the Company or any representative previously submitted the same or similar issues to the Department and withdrawn the request before a PLR was issued.

6. The Company requests that certain information be redacted from the PLR prior to dissemination to others. The Company requests that its name, address, the name of its representatives be redacted.

STATEMENT OF MATERIAL FACTS

The Company is a provider of software as a service (“SaaS”) and cloud-based remote work tools for collaboration, information technology management and customer engagement. The Company was founded in YEAR and is headquartered in CITY, STATE. The Company is registered with the Department to remit Illinois SOT on sales of its services as discussed below.

The Company provides customers with remote access via a SaaS platform to computer hardware that allows access to web-conferencing capabilities. To facilitate this service it is necessary to link a user’s computer or mobile device to the Company’s servers through the use of an applet. This applet is downloaded from the Company’s servers, located outside of Illinois, to the user’s device. The Company provides this applet for free through online and mobile application storefronts, such as STOREFRONT1 and STOREFRONT2. The Company offers a basic version of its service for free to customers, but if users want to upgrade and access additional functionality, they must register and pay a subscription fee to the Company. Note this additional functionality is all remotely accessed cloud-based functionality, and there is no additional software or tangible personal property transferred from COMPANY to its customers.

The Company does not separately state the applet from the SaaS offering on the customer's invoice. Instead, COMPANY has elected to present these charges on the invoice as one single charge. As a result, the Company has historically elected to charge customers SOT at 50 percent of the total price of the invoice. Additionally, the City of Chicago audited the Company and required COMPANY to impose Chicago's Personal Property Lease Transaction Tax ("Lease Tax") on invoices to Chicago-based customers. Currently, the Company continues to charge SOT on 50 percent of its invoices to Illinois customers, as well as the Chicago Lease Tax.

COMPANY does not sell any tangible personal property, sell any other delivered software, and is not otherwise required to be registered for Illinois Retailers' Occupation Tax ("ROT").

RULING REQUESTED

1) On behalf of the Company, we respectfully request the Department to rule that the Company is not required to collect and remit SOT on 50 percent of the charge for the subscription fee the Company bills to customers.

2) Additionally, we also respectfully request the Department to rule that the Company does not incur a Use Tax liability on the provision of applet offered to customers free of charge.

RELEVANT AUTHORITIES

Generally, the sale of "canned" computer software is considered a taxable retail sale in Illinois. 35 ILCS 105/3. Canned software is considered tangible personal property regardless of the form by which it is transferred or transmitted, "…including tape, disc, card, electronic means, or other media." 86 Ill. Adm. Code 130.1935. However, pursuant to 86 Ill. Adm. Code 130.1935(c)(3) a license of canned software is not a taxable retail sale in Illinois if it meets the following criteria:

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.

Illinois does not impose Illinois Retailers' Occupation Tax ("ROT") or SOT on cloud-based software that is accessed only remotely and is never downloaded to a customer's computer (i.e., SaaS) in Illinois. *See* Illinois General Information Letter ST-20-0018-GIL (Sept. 28, 2020). In Illinois, a provider of SaaS is deemed to be acting as a serviceman. *See* Illinois General Information Letter ST 17-0006-GIL (March 2, 2017). SOT is imposed upon all persons engaged in the business of making sales of service on tangible personal property that is transferred incident to the sale of the service. 35 ILCS 115/3.

A "full" serviceman is required to remit SOT on the selling price of tangible personal property transferred incident to sales of service if the cost ratio between the tangible personal property and the serviceman's total annual gross receipts from all sales of service is 35 percent or greater. *See* 86 Ill. Adm. Code 140.106(a). The Serviceman has two options for invoicing, it either can separately state the selling price of the tangible personal property on the billing statement to a customer or; if the serviceman's bill to a customer does not separately state the price of the tangible personal property transferred, then SOT is based on 50 percent of the entire single charge on the customer bill (but not less than the serviceman's cost). *Id*.

A "de minimis" serviceman is a serviceman whose cost ratio between the tangible personal property and the serviceman's total annual gross receipts from all sales of service is less than 35 percent. 86 Ill. Adm. Code 140.108 and 86 Ill. Adm. Code 140.109. A serviceman that is deemed to be a "de minimis" serviceman has three options available to it for determining its tax liability. A "de minimis" serviceman may either incur SOT on the serviceman's cost price of tangible personal property (if

required to be registered for other reasons) or Use Tax ("UT") on the serviceman's cost price of tangible personal property. *Id.* Finally, a de minimis serviceman can elect to be treated as a full serviceman and collect tax as outlined above. *Id. (the two options noted above, separately state or 50% of total single charge).*

A "de minimis" serviceman is deemed to be the end user of the tangible personal property transferred to its service customers, and the customer incurs no tax liability. *See* 86 Ill. Adm. Code 140.108(a). The "de minimis" serviceman should remit UT to suppliers at the time of purchase. *Id*. If the supplier is not registered to collect UT, the "de minimis" serviceman can register for the limited purpose of self-assessing and remitting its UT liability to the Department. *Id.*

Recent Illinois General Information Letters ("GIL") have addressed situations in which a serviceman incidentally transfers software in the provision of a service via an app store such as STOREFRONT2 or STOREFRONT1.

In ST 19-0007-GIL, the Department found that when an Illinois customer downloads free software from an out-of-state retailer's server that is also located out-of-state, the retailer is not liable for UT because the retailer exercises no power or control over the property in Illinois. *See* Illinois General Information Letter ST 19-0007-GIL (March 20, 2019). In this situation, the customer would incur no UT liability either. *Id*. Alternatively, the Department has determined that when a serviceman provides an API, applet, desktop agent, or a remote access agent to enable a subscriber to access the provider's network and services, the subscriber may be receiving computer software subject to tax unless the transfer qualifies as a nontaxable license of computer software. *See* Illinois General Information Letter ST 17-0006-GIL (March 2, 2017). If the provider qualifies as a de minimis serviceman, the provider may elect to pay UT on its cost price of the computer software. *Id*.

ANALYSIS

The Company is not required to collect and remit SOT on 50 percent of the subscription fee to its customers. The applet is offered for free to customers whether they are charged a subscription fee for the enhanced SaaS application or whether they are enrolled in the basic plan that is made available free of charge. Given that the applet is made available for free to all users, is provided by an out of state retailer from out of state servers, the charge to customers for the subscription fee likely represents

a charge solely for SaaS and should be afforded the same tax treatment as the taxpayer in ST 19-0007-GIL (applet provided for free from out of state servers does not result in use tax obligations to either the seller/donor or buyer/donee). As mentioned previously, SaaS is not considered to be tangible personal property and is not subject to tax. Therefore, the subscription fee represents a charge solely for a service not subject to tax under either Illinois ROT or SOT.

In the event that the subscription fee is deemed to represent a charge for both the applet and the SaaS product, the Company would still not be required to collect and remit SOT on 50 percent of the subscription fee because the Company would qualify as a “de minimis” serviceman (unless of course the company elected to be treated as a full serviceman and collect utilizing the 50 percent method). The value, and by extension the cost, of the applet to the Company is inconsequential as illustrated by the Company making the applet available to all users free of charge. Even if a nominal value were to be assigned to the applet this value would never exceed a threshold of a 35 percent cost ratio between the applet and the Company's total annual gross receipts from all sales of service. As a result, the Company would qualify as a “de minimis” serviceman and would be required to incur either SOT or UT on the cost price of the applet, unless SOT or UT is otherwise not due.

CONCLUSION

Since the Company’s cost ratio is less than 35 percent, the Company is not required to collect and remit SOT on 50 percent of the subscription fee to their customers. The applet is offered for free to customers whether they are charged a subscription fee for the enhanced SaaS application or whether they are enrolled in the basic plan that is made available free of charge.

Furthermore, similar to the taxpayer in ST 19-0007-GIL, the Company should not be required to remit UT on the cost price of the applet as the Company is an out-of-state retailer that does not operate servers in Illinois and does not exercise power or control over the applet in Illinois when downloaded by Illinois customers via online app stores. Accordingly, no UT liability incurred by either COMPANY or its customers.

If the Department cannot reach a conclusion based on the information provided, we respectfully request that the Department contact the undersigned to determine what additional information is required.

> By email dated November 17, 2021, the Company's representative at CPA confirmed the "app is only provided for free and the app is not represented in the invoice as a single charge since the app is provided for free. … Arguably the second sentence could be stricken."

DEPARTMENT'S RESPONSE:

Retailers' Occupation Tax and Use Tax

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 retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales. If the purchases occur outside Illinois, purchasers must self-assess their Use Tax liability and remit it directly to the Department.

Service Occupation Tax

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 of tangible personal property transferred incident to service; (2) 50% of the serviceman's entire bill; (3) Service Occupation Tax on the serviceman's cost price if the serviceman is a registered de minimis serviceman; or (4) Use Tax on the serviceman's cost price if the serviceman is de minimis and is 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' 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.

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.

Analysis

It is the Department's conclusion that the Company is acting as a serviceman when it provides its software as a service and cloud-based remote work tools.

The Company confirmed that Illinois customers download the applet for free, and there is neither a separate charge for the applet, nor is a charge for the applet included in the charge for a subscription. Illinois customers also download the applet from a server that is located out of state. It is the Department's conclusion the Company incurs no Use Tax liability for providing the applet to Illinois customers.

As noted above, Illinois does not impose occupation or use taxes on subscriptions. The Company is not liable for occupation or use tax on the subscription fees.

The factual representations upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the factual representations recited in this ruling are correct and complete. This Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this letter under the provisions of 2 Ill. Adm. Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

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

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