

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

September 11, 2024

COMPANY
Attn: NAME, TITLE
ADDRESS

Dear NAME:

This letter is in response to your letter dated June 24, 2024, 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 <https://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:

This letter is a request for a General Information Letter request (“GIL”) pursuant 2 Ill. Admin. Code §1200.120 on behalf of our client, Company (hereinafter referred to as “Company” or “Taxpayer”). Taxpayer has engaged COMPANY (“COMPANY”) to represent it for purposes of this request.

To the best of Company’s knowledge, the issues addressed in this GIL request are not the subject of an Illinois Department of Revenue (“Department”) audit of Company, nor are the issues presented pending in litigation involving Company. The Department has not provided written guidance on this issue to Company.

I. Facts

Company offers practice management services to healthcare providers and physician’s offices. Company provides its customers with a suite of network healthcare solutions which permit healthcare providers to deliver better and more patient care. Company’s service offerings assist healthcare providers

in the entire patient treatment lifecycle – from patient intake, insurance billing and management, medical record documentation, patient engagement, invoicing patients and insurance carriers, and claims follow-up.

The interface between Company and its customers is exclusively internet based, and, at the customer's selection, includes access via mobile app. Company's cloud-based platform is housed exclusively on Company's servers which are located outside of Illinois. Physician practice data is securely maintained on Company's servers, and Company does not charge customers separately for data storage, retrieval, or transmission. Company's customers are able to access data through built-in reporting functions or through custom reports.

Company never transfers any software or software license to its customers, nor does Company ever install its proprietary software on a customer server or hardware. Java software, known as "applets", are sometimes downloaded onto a user's personal server or hardware during the course of a web-based browser session, but these applets have no independent value or use apart from facilitating the web browser session. Company never sells or transfers any tangible personal property while providing its services to its customers as part of the services discussed herein.

Company's primary service offerings are Billing and Claims, Manager and Transmitter. In some instances, Company bundles these three service offerings together as its Bundled Base package. When a customer signs up for one or more service offerings from Company, the contract requires the customer to pay initial implementation fees in addition to a monthly service charge. The implementation fees cover the set-up of the practice on Company's systems as well as any assistance from Company's personnel to facilitate the set-up process and perform the initial user training with the customer's staff, sometimes for an additional fee. Thereafter, Company's monthly service charges are based on the service offerings selected by the healthcare provider and typically determined based on a percentage of the medical provider's revenue. Alternatively, in some instances, the monthly service charges are imposed at a flat rate based on the number of practitioners in a medical practice or the number of claims processed. Where the customer purchases Bundled Package Base, the customer receives the suite of services for one monthly charge. Company does not provide any internet, telephone, or facsimile connections to its customers. Customers are responsible for obtaining the requisite access to the respective communication services necessary to communicate with Company in the context of all of the service offerings.

Company's internet-based service offerings are described as follows:

Billing and Claims Services

Company's Billing and Claims is a practice management and revenue cycle service offering that manages administrative and billing-related functions for physician practices. Company's customers conduct business in an industry where third-party insurers are a significant source of payments for medical services rendered to patients. Company's service offerings enable its customers to achieve faster reimbursement from payers, reduce billing error rates, increase collections, lower operating costs, improve operational workflow controls, improve patient satisfaction and compliance, and more efficiently manage clinical and billing processes.

The primary Billing and Claims services provided by Company include sending insurance claims, receiving, processing and posting payments from insurance companies and patients, and working the customer's accounts receivable, which consists of tracking insurance claims, investigating claims that have been denied by the insurance company, providing tools that allow customers to determine whether insurance payments comport with those customers' contracted rates, and managing the patient billing cycle by sending patient statements and posting any patient payments Company receives. While the service offering automates certain functions for the healthcare providers, there is significant human involvement required from Company employees when providing this service to its customers. During customer onboarding, Company assigns a dedicated resource to collaborate with the customer to ensure that enrollment paperwork is submitted to the insurance companies. This enrollment work allows the customers to update its pay-to address, sign up for electronic claim submission and adjudication, and receive payment from insurance companies electronically. Company employees and agents, in providing its Billing and Claims service, conduct outreach to payers to determine the status of outstanding medical claims, prepare custom appeal forms when directed by customers, and engage with insurance companies to ascertain any necessary steps to secure payment for claims. Company maintains an electronic eligibility interface with insurance carriers which allows Company to provide insurance eligibility verification prior to a patient's office visit. Company also tracks its customer's practice activity to ensure that charges are captured and properly entered, and claims are generated for each patient visit.

A key component of Billing and Claims is a database of payer-specific reimbursement requirements, researched and regularly updated by Company, that facilitates the full and accurate payment by health insurers

of patient bills. Company employees work directly with its customers to submit insurance claims and collect patient balances, communicating with each other via claim notes within the user interface. Each customer grants Company the authority to submit claims on its behalf. Relying on its database of reimbursement requirements, Company employees can analyze, process, and submit claims on behalf of its customer in accordance with the insurance carrier's requirements. As part of its submission, Company must ensure that all required information is gathered and presented appropriately for adjudication. Company tracks the status of claims, including calling payers, reviewing faxes, checking payer portals, and sending demand letters for claim statuses. For denied claims, Company employees review the claim denial explanation, and analyze whether the claim denial was appropriate. This includes reviewing medical service eligibility and when necessary, taking necessary steps including contesting the insurance carrier's claim denial. As part of this process, when appropriate, Company employees resubmit denied claims after its customer has made appropriate corrections.

In resolving claims, Company may use a proprietary tool to access third-party web portals such as a payer's website and APIs on its customer's behalf to submit documentation required by payers. Company also generates patient billing statements for its customer's patients. Finally, Company facilitates the transfer of outstanding patient balances to a customer's designated collection agency based on policies and procedures as determined by its customer.

Manager Services

Company's Manager service offering provides managed and automated medical record- and patient workflow-related services for healthcare providers, including an electronic health record management service. Manager captures and stores pertinent patient data, including an electronic chart which summarizes each patient's relevant medical and demographic information, encounter documentation, orders, results, patient interactions and questionnaires, clinical reminder tracking, and workflow task management. Manager also enables Company's customers to manage outbound prescriptions, place outbound orders, and obtain results that Company connects to the antecedent order where possible. Company's customers determine and configure which information is to be shared directly with their patients.

Through its Manager service offerings, Company presents its customers with a library of global content, including clinical templates for documenting patient care (such as history of present illness, review of systems, medical

procedures, and physical exam), clinical guidelines reflecting medical standards and best practices, curated lists of permissible orders, and guidance related to drug-drug and drug-allergy interactions. Customers can modify the defaults within the user interface to customize, for example, screening questionnaires, patient information forms, and clinical templates.

Customers authorize Company to exchange data with other sources including state health reporting organizations and other third-party providers that facilitate more efficient patient care collaboration. Customers can input patient data and details from patient visits through using a variety of methods including – typing into or making selections from within templates provided from Manager document libraries, voice-to-text entries, and labeling hand-written documents with barcodes that are sent to Company for incorporation into electronic records.

Company also takes on responsibility for classifying and processing documents that are sent to its customers by third parties (including other physicians, pharmacies, and labs). Company's dedicated team processes incoming documents, organizes the documentation by patient, and presents them to the physician's practice. Documents that Company has access to are classified by type (e.g., lab result, consult letter, etc.), matched to the correct patient chart, tied to outstanding orders (if applicable), verified for classification, and entered into the Company database utilized by the customer. Company may also distribute prescription renewals, referrals, consultation letters and authorizations, relieving the physician's staff of these tasks. Manager utilizes fax services provided by third-party vendors and telecom providers to render its services. In addition, Manager also has a secure messaging function where customers can send messages to known trusted recipients using a standard internet connection.

Through Company's co-sourcing model, data entry tasks are completed through a combination of Company's services and the efforts of its customer's medical practice staff. The Manager services incorporate approximately 16 million documents into the database each month, including facsimiles received from lab service providers and others. Facsimiles are reviewed, coded, and integrated into the database by a staff of approximately 1,100 Company employees and contractors, using a multi-level, multi-reviewer scanning, categorization and data entry process or through automated processes established by Company. Many of Company's Manager customers participate in quality management programs managed by government or private payers. Company personnel support customers' participation in these programs, including program data submission and audit support with respect to certain programs. Finally, Company offers Manager customers the Bundled Package app which

serves as an extension of Manager for desktop and iOS devices allowing customers to use Manager to accomplish a subset of clinical tasks on the go.

Transmitter Service

Company's Transmitter service offering provides its customers with a set of tools and services that allows on-demand, automated and live interaction between patients and provider practices both pre- and post-visit, including unlimited use of the patient portal. Company's Transmitter service consists of three primary tools: (1) messaging, (2) access to live operators; and (3) patient portal. The service involves significant human effort from Company subcontractors as well as automated processes. Transmitter is not sold as a standalone service, but is instead only provided in conjunction with either Manager, Billing and Claims, or both.

Transmitter includes an automated appointment reminder system that allows patients to either confirm the appointment or request rescheduling through a live operator. It is also used to remind patients to make appointments for various wellness visits including cancer screenings, annual physicals, and vaccinations. Lastly, phone calls and text messages are sent to alert patients to the availability of results.

Transmitter service offers live operators who take redirected calls from its customers. Where authorized by its customer, live operators can schedule patient appointments following the customers' scheduling protocols, collect patient payments, and patient messages which are relayed to its customers following the customers' defined processes, namely through the user interface customers use for Billing and Claims and Manager. Live operators are available from 10:00 AM to 8:00 PM ET Monday through Friday, excluding major holidays.

Through the patient portal, patients can send secure messages to their healthcare provider and complete online check-in through the patient portal as well as schedule appointments. The patient portal allows healthcare providers to securely initiate, receive, and respond to patient messages. Patients are directed to log in to their patient portal account to view patient health information or account statements. Customers with Bundled Base package service can use the patient portal for online self-check in prior to the appointment. Post-appointment, customers can send lab results to patients, send patient questionnaires, send notices for unpaid balances, and collect payments from patients. The customer portal used in the Transmitter services is web based and hosted by Company so that physician practices do not need software, servers, or phone lines to use it.

II. Issues

1. Whether Illinois customers' purchases of Manager, Billings and Claims, or Transmitter are subject to the Illinois Retailers' Occupation Tax or Illinois Service Occupation Tax?
2. Whether Illinois customers' purchases of Manager, Billings and Claims, or Transmitter are subject to the Illinois Telecommunications Excise Tax?

III. Relevant Statutes, Regulations, and Rulings

The Illinois Retailers' Occupation Tax Act (hereinafter "ROT") 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.

A. Illinois Retailers' Occupation Tax

i. Taxation of Software

Canned computer software in Illinois is defined as tangible personal property and subject to tax. 35 ILCS Chapter § 120/2; 35 ILCS Chapter § 115/3; 35 ILCS §105/3-25; 86 Ill. Admin. Code §130.1935(a). Canned computer software is considered tangible personal property regardless of the form in which it is transferred. Custom computer software, however, which are prepared to the special order of the customer is not subject to ROT. *Id.*

Furthermore, a transaction for the license or transfer of computer software which meets all of the criteria provided in 86 Ill. Admin. Code Section 130.1935(a) will not be subject to ROT, even where a transfer of a software or subsequent software updates occur. Per 86 Ill. Admin. Code Section 130.1935(a), 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.

Illinois has not adopted any specific regulations addressing SaaS. Generally, cloud computing services are not subject to tax within Illinois at the state level, rather, the state views these transactions as transfers of intangible information or data. Ill. Dept. of Rev. GIL ST 17-0006 GIL (March 02, 2017); Ill. Dept. of Rev. GIL No. ST 10-0062-GIL (August 04, 2010); Ill. Dept. of Rev. GIL ST 20-0009-GIL (June 09, 2020); Ill. Dept. of Rev. GIL No. ST 21-0001 (January 15, 2021); Ill. PLR, No. ST 20-0004-PLR (June 10, 2020); Ill. PLR, ST 10-0003-PLR (June 10, 2020). If no tangible personal property is transferred, the transaction is generally not subject to retailers' occupation tax nor use tax. Ill. Dept. of Rev. GIL ST 17-0006-GIL (March 02, 2017).

If the provider transfers to the customer an API, app, desktop agent or a remote access agent to enable the customer to access the provider's network and services, the subscriber may be receiving taxable 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 nontaxable license of computer software. *Id.* Illinois does not tax subscriptions. Ill. Dept. of Rev. GIL ST 21-0001-GIL, 01/15/2021.

ii. Taxation of Services

The ROT does not apply to sales of service. Under the Service Occupation Tax (“SOT”), 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 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.

iii. Bundled Transactions

Sales that include tangible personal property and non-taxable services in one single charge to the consumer are subject to sales tax on the full sales price. When the taxable and non-taxable items are bundled into a single package and sold for at a set price, the entire package is taxable because the non-taxable services items are not separately stated as required under Illinois' ROT regulations to maintain their non-taxable nature. Ill. Dept. of Rev., GIL ST-09-0023-GIL (01/16/2009). Servicemen may separately state the selling price of each item transferred as a result of the sale of service. See 86 Ill. Adm. Code §140.106; Ill. Dept. of Rev. GIL ST 12-0059 GIL (11/29/2012). The tax is then calculated on the separately stated selling price of the tangible personal property transferred. *Id.* If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. *Id.*

B. Illinois Telecommunications Excise Tax

Telecommunications services are not subject to the Illinois sales and use tax but are instead taxed under the Illinois Telecommunications Excise Tax (“TET”). 35 ILCS Chapter §630/1 et seq. The Illinois TET is imposed upon the act or privilege of originating in this State or receiving in this State interstate telecommunications by a person in this State purchased at retail from a retailer by such person. 35 ILCS 630/4.

The definition of “telecommunications” includes, without limitation, messages or information transmitted through use of local, toll and wide area telephone service; private line services; channel services; telegraph services; teletypewriter; computer exchange services; cellular mobile telecommunications service; specialized mobile radio; stationary two way radio; paging service; or any other form of mobile and portable one-way or two-way communications; or any other transmission of messages or information by electronic or similar means, between or among points by wire, cable, fiberoptics, laser, microwave, radio, satellite or similar facilities.

The definition of “telecommunications” does not include value added services in which computer processing applications are used to act on the form, content, code and protocol of the information for purposes other than transmission. Additionally, “telecommunications” does not include purchases of telecommunications by a telecommunications service provider for use as a component part of the service provided by him to the ultimate retail consumer who originates or terminates the taxable end-to-end communications. ILCS Chapter 35 § 630/2(c).

In both IL ST 12-0041-GIL and ST 16-0032 the Department notes that if a company provides a service and the communications provided were merely a component of that service, the service provider would be liable for TET on telecommunications services purchased from vendors and used by it to provide its services.

IV. Ruling Request and Application

Company requests the Department’s guidance that the ROT, SOT and TET does not apply to any of Company’s offerings. In support of this request, Company provides as follows:

A. None of Company’s service offerings are subject to Illinois ROT or SOT

Illinois ROT does not apply to any of Company’s service offerings – Billing and Claims, Manager, and Transmitter services. Company’s service offerings are not subject to Illinois ROT because the ROT does not apply to the sales of pure services, such as personal services, professional services, or repair/maintenance or installation services. Further, as Company does not sell any tangible personal property to its customers pursuant to its service offerings and therefore, would also not be subject to the Illinois SOT.

Company provides back-office practice management services to healthcare providers (hospitals and physician offices). Company uses a cloud, web-

based based platform to perform its services, and in some instances, enables its customers to utilize the web-based portal to interact and display information for its customers. With some service offerings, Company's customer and the customer's patients can also elect to use of a mobile app. However, in the provision of these services there is no execution of a software license by our client's customer, or the patient.

Specifically, in regard to the Billing and Claims service, this practice management and revenue cycle service offering manages administrative and billing related functions of physician practices. The service offering includes our client sending insurance claims, receiving, processing and posting payments from insurance companies and patients, working customer's A/R. Company employees pursue claims, accounts receivables and reconcile patient accounts on behalf of its customer.

In regard to the Manager services, Company offers managed and automated medical record and patient treatment services for healthcare providers, including electronic health record management. Company captures, organizes and displays pertinent patient data in the customer portal. This service also enables its customers and patients to manage outbound prescriptions and other medical service orders. Additionally, Manager provides its customers with a library of medical related content including clinical templates for documenting patient care and medical as well as information related to the underlying health conditions that the patient is seeking treatment for. This service offering relies on more than 1,000 individuals to review, scan, categorize and data process the documentation and tag to appropriate patient.

Lastly, in regard to its Transmitter services, Company's customers receive a service that enables them to engage in on demand, automated and live interaction with their patients. Company's Transmitter service offering enables it customers to send appointment reminders, reminders to pick up prescriptions, and schedule appointments. This service is never provided on a standalone basis; but instead, is provided in conjunction with one or both of the services above.

Even if in the provision of any of Company's service offerings above, Company transferred tangible personal property in the view of the Department, the "true object" of the sales of such services is best categorized as professional services provided by Company, which are not subject to tax in Illinois. However, since no tangible personal property is transferred from Company to its customers, no true object test analysis is required.

B. Company's service offerings are not subject to the Illinois Telecommunications Tax.

The Illinois TET does not apply to Company's Manager, Billing and Claims, or Transmitter services because these service offerings do not meet the definition of "telecommunications" as defined by Illinois law.

The TET is imposed upon the act or privilege of originating or receiving intrastate or interstate telecommunications in Illinois. 35 ILCS §630/1. This tax is imposed on all person originating or receiving telecommunications in Illinois. The definition of "telecommunications" in addition to the meaning ordinarily and popularly ascribed to it, includes, without limitation, messages or information transmitted through use of local, toll and wide area telephone service; private line services; channel services; telegraph services; teletypewriter; computer exchange services; cellular mobile telecommunications service; specialized mobile radio; stationary two way radio; paging service; or any other form of mobile and portable one-way or two-way communications; or any other transmission of messages or information by electronic or similar means, between or among points by wire, cable, fiberoptics, laser, microwave, radio, satellite or similar facilities. 35 ILCS §630/2. Further, Illinois does not tax internet access charges as the Internet Tax Freedom Act ("IFTA") and subsequent federal laws prohibit such taxation. Here, none of Company's service offerings fall within the definition of "telecommunications" that would subject them to tax in Illinois.

i. Billing and Claims Services

The Billing and Claims service is a combination information services, billing and collection services. Company submits insurance claims, receives, processes and posts patient payments, and reconciles its customer accounts receivable, which consists of tracking insurance claims, investigating denied claims by the insurance company, providing information that allow customers to determine whether insurance payments comport with those customers' contracted rates, and managing the patient billing cycle reconciling patient statements with patient payments. To the extent information is transmitted as part of this service, it is done so either through exempt internet-based means, or through the use of telecommunications services purchased from third parties. Accordingly, the Billing and Claims service is not subject to communications tax.

Further, although the Billing and Claims service involves Company's consumption of telecommunications services purchased from third parties, Company does not provide the communications infrastructure for the requisite electronic transmission, conveyance, or routing of voice, data,

audio, video data necessary to impose the TET. To the extent Company purchases taxable telecommunications services from a telecommunication services provider, Company pays taxes on its purchases. Company never provides any internet, telephone, or facsimile connection services to its customers. Instead, Company's customers are responsible for securing the necessary access to the communication services that are necessary to communicate with and obtain services from Company.

ii. Manager services

Manager services are an information service that is not subject to TET. The Manager services allow customers to generate, store, and process patient health information for the purpose of efficient medical practice management and does not fall within the definition of "telecommunications" that would subject it to tax pursuant to the TET. Company's manager services are a pure service offering involving data processing and other services that allow data to be generated, acquired, stored, processed, or retrieved and delivered by an electronic transmission to the medical provider, or its patient, whose only purpose for the underlying transaction is the processed data or information. *Id.* Company's core offering captures and stores pertinent patient data, treatment orders, results, patient interactions and questionnaires, clinical reminder tracking, and workflow task management. Manager services also assists Company's customers' management of outbound prescriptions, place outbound orders, and obtain patient results. Accordingly, Company's manager service offerings do not fall within the purview of the Illinois TET.

To ensure patient privacy and provide its services, Company contracts with third-party vendors that provide inbound and outbound faxing services to Company's customers. Notably, Company interacts with the third-party vendors through online application portals which transmit information for outbound faxes and receive information from inbound faxes as TIFF images (*i.e.*, e-faxes). Further, Company is the purchaser, rather than the provider, of telecommunication services. Moreover, Company does not collect a separate charge for any e-faxes received or transmitted to its customer.

iii. Transmitter Services

The Transmitter service is exempt from Illinois TET because it is a pure service offering and Company does not provide any tangible personal property as part of the service. While Transmitter does facilitate communication between patients and medical providers through messaging, live operators and a patient portal, Company consumes the telecommunication services in its retrieval and presentment of patient data

to medical providers and their patients, it does not provide such telecommunications services. Further, “telecommunications” does not include purchases of telecommunications by a telecommunications service provider for use as a component part of the service provided by him to the ultimate retail consumer who originates or terminates the taxable end-to-end communications. 35 ILCS Chapter § 630/2(c). As such, Company’s Transmitter services are not subject to the Illinois TET.

V. Conclusion

Company respectfully requests the Department to review this GIL request and provide confirmation on the analysis of the law provided above.

If you require any additional information to perform your analysis or would like to discuss or clarify the facts and circumstances, please contact me at EMAIL. We look forward to working with you to resolve this matter.

DEPARTMENT’S RESPONSE:

As noted in the introduction to this letter, persons seeking binding letter ruling must comply with the procedures for private letter rulings found in the Department’s regulations at 2 Ill. Adm. Code 1200.110. For example, requests must be made on behalf of an identified taxpayer. 2 Ill. Ad. Code 1200.110(a)(1). The purpose of a General Information Letter, or 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.

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.

Retailers’ Occupation Tax and Use Tax do not apply to sales of service. See 35 ILCS 120/2; 35 ILCS 105/3. 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.

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.

Please note that it is very common for software to be licensed over the internet and for the customer to check a box that states that the customer accepts the license terms. Acceptance in this manner does not constitute a written agreement signed by the licensor and the customer for purposes of subsection (a)(1)(A) of Section 130.1935. To meet the signature requirement for an exempt software license, the agreement must contain the written signature of the licensor and customer. An electronic agreement in which the customer accepts the license by means of an electronic signature that is verifiable and can be authenticated and is attached to or made part of the license will comply with this requirement. 86 Ill. Adm. Code 130.1935(a)(1)(A).

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 to its supplier 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 generally does not tax subscriptions of software-as-a-service.

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.

“Telecommunications”, in addition to the meaning ordinarily and popularly ascribed to it, includes, without limitation, messages or information transmitted through use of local, toll and wide area telephone service; private line services; channel services; telegraph services; teletypewriter; computer exchange services; cellular mobile telecommunications service; specialized mobile radio; stationary two way radio; paging service; or any other form of mobile and portable one-way or two-way communications; or any other transmission of messages or information by electronic or similar means, between or among points by wire, cable, fiber-optics, laser, microwave, radio, satellite or similar facilities.”

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).

“Gross charges” does not include charges for the storage of data or information for subsequent retrieval or charges for the processing of data or information intended to

change its form or content. 35 ILCS 630/2(a)(3). Charges for automated data storage, retrieval and processing services or for the use of computer time or other equipment are not included in gross charges. Automated information retrieval or data processing charges are not included in gross charges. For example, a customer who accesses an on-line computer data base is not subject to tax on the charge for the data processing or inquiry but would be subject to tax on any charge for the transmission of the data. 86 Ill. Adm. Code 495.100(c).

Telecommunications that are purchased, used or sold by a provider to enable users to connect to the Internet or to otherwise enable users to access content, information or other services offered over the Internet are subject to the federal moratorium. 47 USCA § 151 note; § 1101(B).

A company that purchases telecommunications to provide a service and any communications that are provided are merely a component of that service may not be subject to Telecommunications Excise Tax on the communications provided as part of the service. The determination whether the company is providing a service or telecommunication services depends on the facts and must be made on a case-by-case basis. ST 16-0032-GIL (July 29, 2016).

I hope this information is helpful. If you require additional information, please visit our website at <https://tax.illinois.gov/> or contact the Department's Taxpayer Information Division at (800) 732-8866.

Very truly yours,

Richard S. Wolters
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RSW:sce