

This letter rescinds and clarifies ST-05-0028-PLR. 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. See 86 Ill. Adm. Code 130.1935. (This is a PLR.)

June 29, 2006

Dear Xxxxx:

This letter is written to rescind the Department's previous response (ST-05-0028) regarding your letter dated September 30, 2004. The Private Letter Ruling portion of the Department's response remains unchanged, however, the general information portion has been revised. It has come to the Department's attention that the general information ruling contained in the Department's response stated inaccurate information regarding application of the proper tax to maintenance agreements.

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 ABC 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 ABC 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:

ABC, is a global provider of predictive analytic computer software and services. ABC is currently not under audit and there is no litigation pending with IL department as well.

ABC would like a tax ruling on the following items:

1. ABC sells maintenance services. A customer who purchases maintenance receives for one year, enhancements, upgrades and improvements to the

software, when and if developed, and reasonable efforts to correct errors or deficiencies in the software. Maintenance further includes reasonable technical assistance via the telephone or email. Whenever upgrades become available, we ship CDs or, in some situations, we allow the software to be downloaded from the Web. In all cases, except where the customer purchases maintenance via the Web, the customer signs an agreement that contains the maintenance terms in Section 2 whenever they purchase maintenance. Should we charge tax on this type of sale?

2. ABC sells consulting services to its customers. These services are related to its software. For example, for the ABC NAME software, ABC may build a software model that the customer can use when running NAME. When selling consulting, the consulting terms in the attached agreement and a statement of work outlining the services to be performed are the legal documents between the parties. Should ABC charge tax for this type of sale?
3. When ABC ships software to a customer, ABC charges the customer for shipping the software. Should ABC charge tax on the cost of shipping?
4. ABC provides customers with training on its software. The customer does not sign an agreement for training. Should we charge the customer tax when they purchase training? If the customer just purchases the training guide (a manual) from us, should we charge tax on this type of sale?
5. ABC sells single-user licenses of its software on the Web. When a customer purchases an ABC single-user license, the customer does not sign a license agreement. The license agreement is a shrinkwrap agreement that is included with the Software. Should ABC charge tax for this type of sale?
6. ABC sells documentation for its software on the Web. The customer does not sign any documents when this sale is conducted. Should ABC charge tax for this type of sale?
7. ABC sells maintenance services over the web. When maintenance is sold over the Web, the customer does not sign a document, but rather just 'clicks and accepts' the terms (see attached print out from the ABC Website). Should ABC charge tax for this type of sale?

We'd appreciate it if you can provide us with a written private ruling letter as soon as possible advising on how the sales and use tax applies to the various items above.

I look forward to your reply.

DEPARTMENT'S RESPONSE:

PRIVATE LETTER RULING:

Generally, sales of "canned" computer software are taxable retail sales in Illinois. Sales of canned software are taxable regardless of the means of delivery. For instance, the transfer or sale of canned computer software downloaded electronically would be taxable.

However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See subsection (c) of 86 Ill. Adm. Code 130.1935. Custom computer programs or software must be prepared to the special order of the customer.

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.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under subsection (c) of Section 130.1935, they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the entire agreements would be taxable as sales of canned software.

Please note that the license agreements in which the customer electronically accepts the terms by clicking ("I accept") do not comply with the requirement of a written agreement signed by the licensor and customer. In order to comply with the requirements as set out in (a)(1) of Section 130.1935 you must have a written "signed" agreement.

It appears that the "Software License Agreement" submitted with your letter qualifies as a license of canned computer software and meets the criteria as set out in subsection (a)(1) of Section 130.1935, therefore, neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax.

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.

GENERAL INFORMATION RULING:

Since Illinois taxes are imposed on tangible personal property, consulting services and maintenance agreements for software and hardware will not be subject to Retailers' Occupation Tax or Use Tax. Those services do not constitute tangible personal property. However, with respect to maintenance agreements for hardware, although the maintenance agreement, itself, is not subject to sales tax, any repair parts transferred under the terms of the maintenance agreement will be subject to Use Tax. This is because sellers of maintenance agreements must pay Use Tax to their suppliers

on their cost price of tangible personal property transferred to a customer as an incident of performance of a service or maintenance. See 86 Ill. Adm. Code 140.301(b)(3).

The Service Occupation Tax is a tax on the cost price of any tangible personal property transferred as an incident to a sale of service by a serviceman. "Cost price" means the serviceman's cost price. The serviceman is authorized to reimburse himself for his Service Occupation Tax liability by collecting a corresponding amount of Service Use Tax from his customer. For information concerning these taxes, please refer to 86 Ill. Adm. Code 140.101 and 160.101.

Acceptance of a software license agreement by clicking "accept" while online is not considered "acceptance" sufficient enough to constitute a written agreement signed by the licensor and the customer for purposes of subsection (a)(1)(A) of Section 130.1935. We are without sufficient information regarding the retail sale of documentation that would enable us to render guidance on question number 6.

Handling charges represent a retailer's cost of doing business, and are consequently always includable in gross charges subject to tax. See, 86 Ill. Adm. Code 130.410. However, such charges are often stated in combination with shipping charges. In this case, charges designated as "shipping and handling," as well as delivery or transportation charges in general, are not taxable if it can be shown that they are both separately contracted for and that such charges are actually reflective of the costs of shipping. To the extent that shipping and handling charges exceed the costs of shipping, the charges are subject to tax. As indicated above, charges termed "delivery" or "transportation" charges follow the same principle.

Whether shipping and handling charges may be deducted by retailers in calculating Retailers' Occupation Tax liability depends not upon the separate billing of such shipping and handling charges but upon whether the charges are included in the selling prices of the property or are contracted for separately by purchasers and retailers. The best evidence that shipping and handling or delivery charges were agreed to separately and apart from selling prices, are separate and distinct contracts for freight or shipping. Alternatively, documentation in the records of sellers that purchasers had options of taking delivery of the property at sellers' locations, for the agreed purchase prices, or having delivery made by sellers for the agreed purchase prices plus ascertainable delivery charges, may suffice.

For information regarding training charges in relation to the retail sale of canned software, see 86 Ill. Adm. Code 130.1935(b). In addition, you may find helpful information regarding many of the issues you have raised in your request by visiting the Department's website at the Internet address listed below. General information letters are published under the heading of "Laws/Regs/Rulings."

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I hope this information is helpful. If you have further questions concerning this Private Letter ruling, you may contact me at 782-2844. 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,

Edwin E. Boggess
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