

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.)

August 10, 2007

Dear Xxxxx:

This letter is in response to your letter dated October 31, 2006, in which you request 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 1200.1120. 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 national consulting firm specializing in sales & use tax. Our firm is highly experienced in computer related claims in several states including the state of [sic] Illinois. We have been retained by ABC to evaluate their Master Agreement as it relates to software licensing.

We are seeking to obtain a written opinion on the taxability of software licenses for ABC. ABC is in the business of developing software and reselling hardware to the medical community. After reviewing ABC Master Agreement, we feel that their contract meets all criteria under section 130.1935(a)(1) proving its perpetual nature. As a result, the software licenses granted under this Master Agreement qualify to be exempt from sales tax.

Below is a list of the five criteria and the reasons for which they meet the requirements of state regulation 86 Ill. Adm. Code 130.1935(a)(1).

A license of software is not a taxable retail sale if:

- (1) it is evidenced by written agreement signed by the licensor and the customer
 - Both ABC and their customer sign the Master Agreement prior to any shipment of software: 'This agreement shall become effective upon the signature hereof by an authorized representative of the Client and ABC(clause 25k).
- (2) it restricts the customer's duplication and use of the software
 - In ABC Master Agreement, the license granted is 'personal, nonexclusive and nontransferable' in which the customer must use the software for its own 'internal business needs' (clause 2).
 - The client may copy the software 'only in non-printed, machine readable form in whole or in part as necessary for Client's authorized use hereunder, including the making of back-up copies' (clause 3).
- (3) 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 or [sic] the licensor
 - In ABC Master Agreement, the client is granted a license that is 'personal, nonexclusive and nontransferable' in which the client 'shall not permit any third party to use the software or grant a sublicense for the use of the software' (clause 2).
 - 'The Client acknowledges that its use of the Operating System and/or Third Party Software may be subject to additional licensing terms from the relevant third party' (clause 4).
- (4) the licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or of 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
 - In ABC Master Agreement, 'the software license granted herein includes the right to copy the object code only in non-printed, machine readable form in whole or in part as necessary for Client's authorized use hereunder, including the making of backup copies' (clause 3).
- (5) 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
 - The definition of perpetual means 'continuing or enduring forever; everlasting' (www. dictionary.com)

- In ABC Master Agreement, the software license is paid for in a lump sum manner rather than annually: ‘Twenty-five percent (25%) of the Price (including all Services)’ is paid ‘upon the execution of this Agreement and the remaining 75% of the Price (including all Services)’ is paid ‘upon the initial installation of the System’ (clause 7) further proving its perpetual nature.
- In ABC Master Agreement, the software license granted is valid ‘unless and until terminated hereunder’ (clause 2). In other words, termination will result only if the customer commits a breach of the agreement requirements. Upon the occurrence of this breach, the customer is required to ‘immediately return the system, and all copies of the software’ (clause 23) to the company.

In conclusion, due to the criteria for state regulation 86 Ill. Adm. Code 130.1935(a)(1) being met, we feel that ABC Master Agreement grants their clients sales tax exemption rights for their software licenses. In order to expedite our review process, a copy of the Master Agreement with our specific reference points highlighted has been enclosed for you.

If you have any further questions regarding these documents, or would like to discuss them with us, please feel free to contact us.

DEPARTMENT’S RESPONSE

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. However, 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.

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.

If you have further questions concerning this Private Letter ruling, you may contact me at (217) 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,

Terry D. Charlton
Chairman, PLR Committee

TC/MPM:mzk