

A license of canned software is subject to Retailers' Occupation Tax liability if all of the criteria for an exempt license of canned software set out in 86 Ill. Adm. Code 130.1935(a)(1) are not met. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

September 24, 2008

Dear Xxxxx:

This letter is in response to your letter dated May 28, 2008, 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 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

ABC is requesting a private letter ruling in accordance with 2 Ill. Adm. Code 1200.110 with respect to the following factual situation. At the time of this request, ABC is not currently under audit by the Illinois Department of Revenue ('the Department'), nor is there litigation pending between ABC and the Department. To the best of our knowledge, the Department has not previously ruled on a similar issue for ABC, and ABC has never submitted a request for a ruling on a similar issue.

ABC's request for ruling relates to whether it's [sic] licensing of software pursuant to a master license agreement qualifies as a license of computer software under 86 Ill. Adm. Code 130.1935 and as such is not considered to be [sic] retail sale of tangible personal property subject to the Illinois Retailers Occupation Tax. Following is a discussion of the facts and our analysis of the law as it pertains to the license agreement and the specific requirements of the regulation.

FACTS:

On, December 19, 2007 XYZ and ABC entered into an Enterprise license agreement for the provision of software. On that date, XYZ agreed to provide and ABC agreed to pay for a license of software for a three year period. A copy of the signed license agreement is attached hereto.

The entire Enterprise Agreement consists of several sections. The sections relevant to this request are the Terms and Conditions, the signature form, and the invoice. These sections are attached to this

The entire Enterprise Agreement consists of several sections. The sections relevant to this request are the Terms and Conditions, the signature form, and the invoice. These sections are attached to this request. The notes on the invoice indicate that the pricing in the license only contemplates an agreed upon number of users. Adding users to the license requires the payment of additional license fees.

LAW:

According to regulation 86 Ill. Admin. Code 130.1935(a)(1), license fees charged in association with software may be exempt from sales and use tax in certain instances. According to the regulation, a license of software is not a taxable retail sale if:

1. it is evidenced by a written agreement signed by the licensor and the customer;
2. it restricts the licensee's duplication and use of the software;
3. it prohibits the licensee 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;
4. the licensor has a policy of providing another copy at minimal or no charge if the licensee loses or damages the software, or of permitting the licensee to take 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
5. the licensee must destroy all copies of the software or return them to licensor at the end of the license period. This provision is deemed to be met if the license agreement is a perpetual license.

Analysis:

It is our position that the license agreement between ABC and XYZ meets the five prong test established in 86 Ill. Admin. Code 130.1935(a)(1).

1. The first prong of the test requires that the license agreement be evidenced by written document, signed by both parties. Attached to this request is a copy of the written license agreement executed between ABC and XYZ. This signed, written agreement satisfies the first prong of the five prong test.
2. The second prong of the test requires that the license restrict the customer's duplication and use of the software. The agreement does this in at least three ways:
 - a. First, the agreement restricts ABC's use of the software by limiting its distribution of the software to 'within its organization' (Sec. 7(a) of the agreement). Such a restriction has previously been found by the Department to satisfy this prong of the test. (ST 07- 0004-PLR). In addition, ABC is allowed to maintain a limited number of copies only for training (20 copies) and evaluation (10 copies). (Section 7(b)). This provision places strict limits on the use of the software by ABC.

- b. Second, ABC is required by the terms of the agreement to insure that any duplicate copies of the software are ‘true and complete (including copyright and trademark notices).’ Furthermore, ABC is required by the agreement to make reasonable efforts to make its employees, agents, and any other individuals that ABC allows to use the software aware that the software is licensed from XYZ and subject to the terms of the agreement. (Section 7(a)).
 - c. Finally, the invoice for the licenses includes a pricing schedule (see ‘Notes’), which contemplates different prices based on the number of users. This ‘notes’ section is incorporated by reference in Section 3 of the agreement. If the licensee changes the number of users authorized to use the software, the price level will be affected. This creates a restriction on the use of the software by ABC.
3. The third prong of the test restricts the licensee's permission to license, sub-license, or transfer the software to third parties except to a related third party). Section 8(a)(i) of the license agreement satisfies this prong of the test. This section permits ABC to transfer the software to an affiliate. Transfers in connection with a divestiture, merger, or consolidation are permitted, but require ABC to provide notice to XYZ on a form created by XYZ. Any other transfers require XYZ's prior written consent.
4. The fourth prong of the test requires the licensor to maintain a policy of providing additional copies of the software at minimal or no charge should the software become lost or damaged. In the alternative, the licensor may allow the licensee to keep an archival copy, and this prong is satisfied if such a policy is stated in the license agreement. Section 7(b) of the agreement specifically states that ABC may ‘use one complimentary copy of any licensed product for back-up or archival purposes for each of its distinct geographical locations.’ This policy satisfies the fourth prong of the test.
5. The last prong of the test requires the licensor to return or destroy any copies of the software at the end of the license period. This prong is deemed satisfied if the license is perpetual. The license agreement at issue represents a perpetual license, and thus satisfies the final prong of the test. Sections 4 and 9 of the license agreement state that the licenses will become perpetual at such time as:
 - a. the contract is fully paid for and the applicable initial enrollment or renewal term has expired, or
 - b. the enrollment is terminated by either party.

We believe that the attached agreement meets all five prongs of the test, and should therefore not be considered a retail sale of tangible personal property subject to the Illinois Retailers' Occupation Tax. We are unaware of any authority contrary to our position. We respectfully request a ruling from the Department regarding the taxability of this agreement.

DEPARTMENT’S RESPONSE:

The Department’s regulation “Public Information, Rulemaking and Organization” provides that “[w]hether to issue a private letter ruling in response to a letter ruling request is within the discretion of

the Department. The Department will respond to all requests for private letter rulings either by issuance of a ruling or by a letter explaining that the request for ruling will not be honored." 2 Ill. Adm. Code 1200.110(a)(4). Further, the Department's regulations regarding Private Letter Rulings provide that "[i]f there is case law or there are regulations dispositive of the subject to the request, the Department will decline to issue a letter ruling on the subject." 86 Ill. Adm. Code 1200.110(a)(3)(D).

After reviewing the materials you provided in connection with your request, the Department declines to issue a Private Letter Ruling. It is the Department's position that its regulation at 86 Ill. Adm. Code 130.1935 is dispositive of the subject of your request, as are several PLRs and GILs that the Department has issued which can be found on the Department's website. Therefore, we are responding with this General Information Letter that we hope will assist you.

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 86 Ill. Adm. Code 130.1935(c). Custom computer programs or software must be prepared to the special order of the customer.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under Section 130.1935(c), 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 whole agreements would be taxable as sales of canned 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.

A license of canned software is subject to Retailers' Occupation Tax liability if all of the criteria set out in 86 Ill. Adm. Code 130.1935(a)(1) are not met.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

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