

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.)

November 24, 2008

Dear Xxxxx:

This letter is in response to your letter dated January 8, 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:

We respectfully request an opinion from the Illinois Department of Revenue regarding the taxability of the transactions outlined below. Please also find attached for your review a redacted copy of taxpayer's master services agreement.

Facts

Taxpayer was formed to design, develop, and market software and managed services which enhances the reliability and security, simplifies the management, and extends the functionality of e-mail systems and other mission critical systems for the enterprise customer. Taxpayer's offerings to customers are provided on a platform that is hosted at datacenters located out of state. The platform provides the maintenance free benefits of on-demand services with the integration capabilities of on-premise software. This platform consists of taxpayer's global network of top-tier disaster recovery centers and minimal client side software installed at the client site. By hosting off-site, taxpayer's services are not dependant on local servers, infrastructure or staff to eliminate the many risks of on-premise enterprise solutions. As noted, the client side software is minimal and it allows the customer's directory, authentication, and storage management systems to be securely synchronized with taxpayer's global datacenters as needed to eliminate system complexity and management headaches.

Taxpayer's offerings to customers are focused on e-mail, crisis notification, and application continuity. These offerings are provided to customers under renewable subscriptions.

With respect to e-mail, taxpayer offers integrated on-demand services which are all delivered from a global network of top-tier disaster recovery datacenters. The e-mail offerings are as follows:

A. Standby E-mail System ((i) in master services agreement)

A standby e-mail system that can be activated in 60 seconds is to make primary email outages invisible to end-users and ensure that data is never lost. In the event of an outage of the customer's primary mail system, the product will queue mail at taxpayer's datacenter and attempt to redeliver it until the customer's primary system comes back online. When the standby e-mail system is activated, users have to access their backup mailboxes.

B. External Hosted Mail Gateway ((ii) in master services agreement)

E-mail security which automatically filters e-mail at the perimeter for spam, viruses and malware. It automatically analyzes hundreds of thousands of attributes of every message to block unwanted content and validates addresses and personal contacts to ensure legitimate messages are not blocked as spam.

C. Hosted E-mail Archive Messaging System ((iii) in master services agreement)

E-mail archiving in which messages are archived at taxpayer's datacenters according to the customer's retention policies and become a long-term archive for compliance and legal discovery. Customers can securely store e-mail and attachments for historical archiving with complete control over retention and deletion policies, legal holds, compliance, storage management and e-discovery and without the risks of data loss or downtime.

Taxpayer also provides crisis notification which is hosted at world-class disaster recovery data centers.

D. Emergency Notification System and Crisis Management Center ((iv) in master services agreement)

During a crisis or emergency, normal lines of communication often fail when they are needed most. Taxpayer's crisis notification service provides two-way communication channels to quickly, securely, and reliably distribute and collect information. By leveraging email, outbound and inbound voice calls, text messages, pagers, BlackBerry® devices, and the internet, this service provides an automated method to find people. An incident collaboration center also allows customers to post task lists, employees can post ongoing status information, and teams, departments and individuals can share critical data appropriate to their roles and needs. For times when the organization's website or the right channel to communicate information related to a crisis is unavailable, the incident collaboration center also provides a hosted external website for outbound communications to customers, vendors, partners, and the world.

Finally, taxpayer provides application continuity.

E. Business Continuity and Disaster Recovery Management ((v) in master services agreement)

This application continuity replicates application data in real-time to the customer's local or remote backup system over a standard network connection. The service includes Web-based and 24/7 expert monitoring of replication performance and failover readiness. When problems occur, the customer can initiate a fully automated failover of all affected applications with a single push of a button or phone call. Within 15 minutes, all applications will be functioning normally from their dedicated backup servers. The offering includes application-specific failover and remediation logic to ensure that complex failovers occur quickly and without incident.

Questions

1. Will the taxpayer's service offerings be considered taxable services? If so, will the location of datacenters impact the taxability of the service offerings?
2. Alternatively, will the taxpayer's service offerings be considered the license of taxable software? If so, will the location of the datacenters impact the taxability of the transaction?

Please contact me at with any questions you may have.

DEPARTMENT'S RESPONSE:

We regret that, in the context of a GIL, we cannot respond to your questions in the requested format. However, we are providing the following general information for your consideration.

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. 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 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois.

Illinois Retailers' Occupation and Use Taxes, however, do not apply to sales of service that do not involve the transfer of tangible personal property to customers. If tangible personal property is transferred incident to sales of service, though, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. For your general information see 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax.

Information or data that is electronically transferred or downloaded is not considered the transfer of tangible personal property in this State. See 86 Ill. Adm. Code 130.2105(a)(3). However, 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.

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It is unclear whether telecommunications is being provided. However, your letter indicates that crisis notification which would involve, among other methods, outbound and inbound voice calls would be provided. Please note that 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. "Gross charges" for private line service shall include charges imposed at each channel termination point within this State and charges for the channel mileage between each channel termination point within this State. The tax imposed shall be collected from the taxpayer by a retailer maintaining a place of business in this State and remitted to the Department. 35 ILCS 630/5.

Moreover, 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. "Gross charges" for private line service shall include charges imposed at each channel termination point within a municipality that has imposed a tax under this Section and charges for the portion of the inter-office channels provided within that municipality. Charges for that portion of the inter-office channel connecting 2 or more channel termination points, one or more of which is located within the jurisdictional boundary of such municipality, shall be determined by the retailer by multiplying an amount equal to the total charge for the inter-office channel by a fraction, the numerator of which is the number of channel termination points that are located within the jurisdictional boundary of the municipality and the denominator of which is the total number of channel termination points connected by the inter-office channel. The tax

imposed shall be collected from the taxpayer by a retailer maintaining a place of business in this State and remitted to the Department. 35 ILCS 636/5-40.

"Sale at retail" means the transmitting, supplying or furnishing of telecommunications and all services and equipment provided in connection therewith for a consideration, to persons other than the Federal and State governments, and State universities created by statute and other than between a parent corporation and its wholly owned subsidiaries or between wholly owned subsidiaries for their use or consumption and not for resale. 35 ILCS 630/2k; 35 ILCS 636/5-7. Counties and other public bodies are not excluded from the definition of a "sale at retail" and are subject to both the Telecommunications Excise Tax Act and the Simplified Municipal Telecommunications Tax Act.

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,

Debra M. Boggess
Associate Counsel

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