

Charges for updates of canned software are fully taxable under Section 130.1935(b) of the Department's rules. If a maintenance agreement provides for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreement would be taxable as a sale of canned software. See 86 Ill. Adm. Code 130.1935. (This is a PLR.)

February 20, 2008

Dear Xxxxx:

This letter is in response to your letter dated November 6, 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 1200.120. 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:

Below is the information that you requested be included in each request for a private letter ruling under Section 1200.110.

1. A complete statement of the facts and other information pertinent to the request:
 - a. We, ABC, are a STATE based company that sells software, service and maintenance. ABC collects sales tax under IL account #. XYZ, a customer of ABC, contacted ABC 11/3/06 asking whether the annual maintenance charged by ABC could be broken down into taxable and non-taxable portions. Currently, since no allocation has been made, the entire maintenance invoice is shown as taxable. The maintenance invoices for XYZ dated 11/1/04, 11/1/05 and 11/1/06 are enclosed.
 - b. The question ABC submits for a Private Letter Ruling is:**

Can ABC, allocate 2/3rds of each annual maintenance invoice as non-taxable based on the circumstances outlined in 2(a)(1) and 2(a)(3) below? Aside from assigning each of the 3 items covered by the annual maintenance 1/3 of the cost, ABC does not have a means of assigning a dollar figure to the upgrade described in 2(a)(2) below.

2. All contracts, licenses, agreements, instruments or other documents relevant to the request:
 - a. A representative contract titled 'Equipment Sales, Software, License and Services Agreement' is attached. Please see specifically page 6 of 8 regarding Software Maintenance Services. Please see on page 6 **detailed** descriptions of each of the following components. Here we have summarized what the Maintenance Services as outlined include:
 1. Repair of Warranty Defects, which are program malfunctions (bug fixes.)
 2. All new Versions and Releases, Product Enhancements, which when available and requested by the customer is a physical software product. If the customer requests an 'upgrade' such as this, the customer pays separately for the services necessary for installation.
 3. Hardware Portability, which is when a customer changes hardware and needs the compatible software from ABC to run on this new hardware. This will occur in one of two ways as follows:
 1. If the customer 'desires to transfer the licensed software to another CPU which is provided by the same hardware manufacturer and uses the same operating system and the same database management system, the customer may do so for no additional license fee.'
 2. If the customer desires to transfer the licensed software to another CPU, provided by a *different* manufacturer with a *different* operating system or *different* database management system, the customer agrees to pay a [separate] software re-host fee of 25% of the total licenses then in use.'
 4. Charges:
 1. 'The customer will be charged [separately] for any services performed hereunder' such as installations, conversions and training on new releases.
 - b. ABC Maintenance Policy
 - c. Maintenance Cancellation Policy
3. Tax period at issue is 2004, 2005 and 2006. No audit or litigation is pending with the Department.
4. To the best of our knowledge, the Department has **not** previously ruled on the same or a similar issue for the taxpayer or a predecessor **nor** has the taxpayer previously submitted the same or a similar issue to the Department but withdrawn it before a letter ruling was issued.

5. A statement of authorities supporting the taxpayer's views, an explanation of the grounds for that conclusion and the relevant authorities to support that conclusion.
 - a. 'Charges, for updates of canned software are fully taxable pursuant to Section 130.1935. 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.'
6. A statement of authorities contrary to the taxpayer's views. The taxpayer determines that there are no authorities contrary to the view stated in #5 above or taxpayer is unable to locate such authority.
7. I do not know of any specific trade secret information that needs to be deleted from the publicly disseminated version of the private letter ruling.
8. As required I, PERSON, President and CEO, for ABC sign below that I am requesting this Private Letter Ruling:

Thank you for your consideration of our request for a Private Letter Ruling. We look forward to hearing back from you. Please contact me if you have any question or require additional information.

DEPARTMENT'S RESPONSE:

In general, maintenance agreements that cover computer software are treated the same as maintenance agreements for other types of tangible personal property. See 86 Ill. Adm. Code 130.1935(b). The taxability of maintenance agreements depends upon whether the charges for the agreements are included in the selling price of the tangible personal property. If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. In this case, no tax would be incurred on the maintenance services or parts when the repair or servicing is performed.

Except as discussed in the following paragraph, if a maintenance agreement is sold separately from tangible personal property, the sale of the agreement is not a taxable transaction. However, when maintenance services or parts are provided under the maintenance agreement, the service or repair company is acting as a service provider under provisions of the Service Occupation Tax Act that provide that when service providers enter into agreements to provide maintenance services for particular pieces of equipment for stated periods of time at predetermined fees, the service providers incur Use Tax based on their cost price of tangible personal property transferred to customers incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3). If, under the terms of a maintenance agreement, a software provider provides a piece of object code ("patch" or "bug fix") to be inserted into an executable program that is a current or prior release or version of its software product to correct an error or defect in software or hardware that causes the program to malfunction, the tangible personal property transferred incident to providing the patch or bug fix is taxed in accordance with this paragraph.

In contrast to a patch or bug fix, if a maintenance agreement offered by a software provider includes charges for updates of canned software, which consist of new releases or new versions of the computer software designed to replace an older version of the same product and which include product enhancements and improvements, the general rules governing taxability of maintenance agreements do not apply. This is because charges for updates of canned software are fully taxable as sales of software under Section 130.1935(b). (Please note that if the updates qualify as custom software under Section 130.1935(c) they may not be taxable). Therefore, if a maintenance agreement

provides for updates of canned software, and the charges for those updates are not separately stated and taxed from the selling price for warranty repairs, training, telephone assistance, installation, consultation, or other charges, then the whole agreement is taxable as a sale of canned software.

You have asked if ABC can assign each of the 3 items covered by the annual maintenance agreement 1/3 of the cost and collect tax on the 1/3 of the charges that represent the upgrade of software. With respect to maintenance agreements that ABC has entered into that do not contain a separately stated charge for upgrades of canned software, ABC may not arbitrarily establish a charge for these updates of canned software and separate that charge from the remaining maintenance agreement charges in order to exempt all of the other maintenance agreement charges from tax. The charges for these agreements are fully taxable. If in future agreements, however, ABC determines and separately states the charge for updates of computer software from the other maintenance agreement charges, Retailers' Occupation Tax is only required to be applied to the charges for updates of canned software. The remaining charges under the maintenance agreement would be taxed in the same manner as other maintenance agreements. To the extent no tangible personal property other than the update is transferred, no additional tax is incurred.

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 the factual representations recited in this ruling.

I hope this information is helpful. 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.

Sincerely,

Terry D. Charlton
Chairman, Private Letter Ruling Committee

TDC/SJM:msk