

This letter concerns the taxation of computer software transactions. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

June 5, 2009

Dear Xxxxx:

This letter is in response to your letter dated May 12, 2009, 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:

In accordance with the provisions of Title 2, Part 1200, Section 1200.110 [sic] as set forth under Illinois state law, we request that the Illinois Department of Revenue provide information regarding the taxability of service transactions involving Application Service Providers ('ASP').

The Department has not previously ruled on this issue, or a similar issue directly to COMPANY, nor, to the best of my knowledge, has a similar inquiry been submitted. COMPANY is not currently under audit by the Department, or involved in any litigation regarding this issue.

We have reviewed numerous rulings on the Department's taxability treatment of ASP transactions, but have been unable to discern a definitive confirmation as to their taxability. Private letter rulings ('PLR's') we have reviewed include both ST 00-0173-GIL, 08/24/2000 and a ruling issued more recently, ST 06-0116-GIL, 05/16/2006.

Can you please advise us of the taxability of the following transactions, as they relate to providers and servers located in state and out of state?

Application Service Provider and Server located in the state of Illinois

Corporation A is located in the state of Illinois and provides a service to Illinois customers. The Illinois customers of Corporation A remotely access and use an application/software that resides on the ASP's servers located inside Illinois. The

software is tool of the ASP because data is applied through the software and the customer can only access the software through the internet to receive the service. Illinois customers do not receive the software in any tangible medium and do not download the application/software to their hardware located in Illinois. For this PLR, we ask three specific questions. For the first question, no license is granted to the customer for access to the application/software:

(1) Is the service of Corporation A, which allows Illinois customers to remotely access applications/ software that resides on a remote server owned by the ASP and located in Illinois where the customer receives no tangible medium and does not have the right to download the application/software, subject to sales or use tax in your jurisdiction?

For the next two questions we propose additional facts in which the ASP confers a license to the customer. The license is part of the contract between Corporation A and the Illinois customer and grants the customer permission to remotely access and use the application/software. The contract states: 'This License is not a sale of the [software] by any right, title or interest therein.' The customer does not receive any rights or powers over the software and the customer cannot download the software or modify or change it in anyway. We specifically ask:

(2) Is the service of Corporation A subject to sales and use tax in your jurisdiction when the ASP grants a license to the customer to remotely access and use the software?

and

(3) Is the service of Corporation A subject to sales and use tax in your jurisdiction where the license is specifically granted for no charge or consideration?

Additional Scenarios

While the questions above relate to an entire transaction occurring in the state of Illinois, we also inquire about the taxability of the following permutations that commonly occur with ASP transactions.

Can you please answer the same question asked above but regarding the following scenarios:

- The ASP is located in the state of Illinois, but the server on which the ASP's software is stored is a remote server that is located outside of the state. The customer accessing the software on the remote server is located inside the state of Illinois.
- The ASP and the remote server on which the ASP's software is stored are both located outside of the state of Illinois. The customer accessing the software on the remote server is located inside the state of Illinois.

Your prompt attention to these questions will be appreciated. If the Department is unable to answer these questions at this point in time, any information that can be provided relating to when the Department plans to issue a statement regarding the

taxability of ASP transactions would be greatly appreciated. If you need any further information, please contact me.

DEPARTMENT'S RESPONSE:

The Department believes that the proper forum for providing guidance regarding transactions involving computer software Application Service Providers (ASPs) is through a formal administrative rulemaking process rather than through individual inquires such as letter ruling requests. Unfortunately, I cannot provide you with a time frame as to when such a rulemaking process will be initiated. I recommend that you monitor the Department's website for information regarding when this rulemaking will be proposed.

The following is some general information regarding the taxation of computer software in this State. Generally, retail sales or transfers of "canned" computer software are taxable in Illinois regardless of the means of delivery. For instance, the sale or transfer 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.

Please note that it is very common for software to be licensed over the internet and the customer to check a box that states that they accept the license terms. Acceptance in this manner

does not constitute a written agreement signed by the licensor and the customer for purposes of subsection (a)(1)(A) of Section 130.1935. To meet the signature requirement for an exempt software license, the agreement must contain the written signature of the licensor and customer.

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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