ST 99-0006-PLR 01/20/1999 COMPUTER SOFTWARE

Transactions for the licensing of computer software may not be subject to ROT if the transaction agreements contain all the criteria set out in 86 Ill. Adm. code 130.1935(a)(1). (This is a PLR.)

January 20, 1999

Dear Mr. Xxxxx:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (see enclosed), is in response to your letter of February 13, 1998. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of the enclosed copy of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither COMPANY 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:

This is a request for a private letter ruling under the provisions of 2 Illinois Administrative Code Section 1200.110 on behalf of COMPANY A power of attorney is attached.

FACTS:

1. COMPANY is a retailer of software products located in CITY, Illinois.

2. COMPANY, is not presently under audit by the Illinois Department of Revenue. Also, there is no pending litigation with the Department.

3. This request is intended to provide a guidance for the collection of tax in future periods.

4. COMPANY has not previously requested nor withdrawn a request for a private letter ruling form the Department.

AUTHORITY:

COMPANY believes that the software that it sells under the attached licenses qualifies for exemption from the Retailers' Occupation Tax under the provisions of 86 Illinois Administrative Code Sec. 130.1935.

86 Ill. Adm. Code 130.1935 provides that 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);

D) the vendor will provide another copy at minimal or no charge if the customer loses or damages the software; and

E) the customer must destroy or return all copies of the software to the vendor at the end of the lease period.

Item (D) requires the license to contain a provision requiring the vendor to provide another copy at minimal or no charge if the customer loses or damages the software. We believe that the Department has deemed a software license agreement to have met this criteria if the agreement does not contain a provision about the loss or damage of the software, but the vendor's records reflect that it has a policy of providing copies of software at minimal or no cost if the customer loses or destroys the software.

Item (E) requires a license to require a customer to destroy or return all copies of the software to the vendor at the end of the license period. We believe that the Department has also deemed perpetual license agreements to qualify for this criterion even though no provision is included in the agreement that requires the return or the destruction of the software.

The Department of Revenue has issued many rulings on the topic of computer software and products which may qualify for the exemption set forth in 86 Illinois Administrative Code Sec. 130.1935. These ruling letters appear to be case by case determinations based upon the specific text of individual license agreements. We do not believe that as such they are precedent with respect to this request for a Private Letter Ruling.

ARGUMENT:

Although there are variations in the terms of each of the licenses, we believe that the licenses meet the requirements of 86 Ill. Adm. Code Sec. 130.1935.

1. The licenses are in writing and are signed by the parties.

2. The licenses restrict the customer's duplication and use of the software (Par 6.0 and 7.0 CPU License).

3. The licenses restrict the customer from licensing, sublicensing or transferring the software to a third party. Licenses may be assigned to a third party only with the written permission of the licensor and payment of a fee of $1,000. (Par. 12 CPU License).

4. The licenses permit the customer to make copies of the software as a part of the customer's automated back-up system and allows an additional copy or archival purposes. Additionally, if the licensee maintains a disaster recovery system, the licensee may keep one copy of the software at a location other than the Designated Computer room for disaster recovery purposes. The licenses also provide for replacement of the software as a remedy for breach of warranty. COMPANY believes that the liberal provision for back-up copies and disaster recovery fulfill the spirit of the regulatory requirement that the vendor provide another copy at minimal or no charge if the customer loses or damages the software. In the unlikely event that all copies of the software are lost of destroyed by a current customer, COMPANY will provide replacement copies of the licensed software at no charge.

5. The licenses are perpetual licenses and contain specific requirements that upon any termination of the agreement, the licensee shall return or destroy all copies of the software and documentation. (Par. 8.2 CPU License)

RULING REQUESTED:

COMPANY, Requests that the Department review each of the licenses submitted with this request and rule that the licenses are not subject to Illinois Retailers' Occupation Tax and Use Tax. I have attached copies of the following licenses:

1. ITEM

2. ITEM

3. ITEM

4. ITEM LICENSE

5. ITEM LICENSE

6. CPU LICENSE

If you anticipate issuing a Private Letter Ruling which does not agree with the ruling requested, I would appreciate the opportunity to meet with you to discuss the issues in greater detail before a ruling is issued. I request that the names of the parties be deleted from any public publication of the letter and that all license documentation submitted with the letter be held as confidential information.

Licenses of software may not be subject to tax if the licenses meet all the criteria set out in 86 Ill. Adm. Code 130.1935(a)(1)(A-E). Please see the guidelines contained in the enclosed copy of 130.1935.

In order to be non-taxable, licenses must include the following provisions: 1. written agreements signed by licensors and customers; 2. restrictions limiting customers' duplication and use of the software; 3. restrictions prohibiting customers from licensing, sublicensing or transferring the software to unrelated third parties; 4. policies or provisions that vendors will provide another copy at minimal or no charge if customers lose or damage the software; and 5. requirements that customers destroy or return all copies of the software to vendors at the end of license periods.

Our review of the license agreements you submitted show that they have written provisions that satisfy requirements 1, 2, 3, and 5, but they do not contain provisions that satisfies provision 4, that the vendor (licensor) will provide another copy at minimal or no charge if the customer loses or damages the software.

While the agreements do not contain explicit provisions that satisfy 86 Ill. Adm. Code 130.1955(a)(1)(D), the Department has deemed a software license agreement to have met this requirement if the agreement does not contain such a provision, but the vendor's records reflect that it has a policy of providing copies of software at minimal or no charge if the customer loses or damages the software. Therefore, if COMPANY's records reflect such a policy, as you indicate in your letter, then this requirement is satisfied.

The facts upon which this ruling are 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 material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions, please feel free to contact the Department.

Very truly yours,

Karl Betz
Associate Counsel

KWB:msk
Enc.