ST 05-0017-PLR 10/12/2005 COMPUTER SOFTWARE

This letter discusses whether certain software agreements qualify as licenses of software and not retail sales of software under the Retailers' Occupation Tax Act. See 86 Ill. Adm. Code 130.1935. (This is a PLR.)

October 12, 2005

Dear Xxxxx:

This letter is in response to your letter dated October 25, 2004, 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 1200.1120. You may access our website at www.ILTAX.com 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 TAXPAYER 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 TAXPAYER 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 request for a Private Letter Ruling is made on behalf of our client, TAXPAYER (hereinafter 'Taxpayer' or 'Customer'). We request a ruling that the enclosed Master Software License Agreement effective December 31, 2002 ('Master Agreement'), as described below (including subsequent amendments), is a license of software that is not a taxable retail sale as provided in 86 Ill. Adm. Code §§ 130.1935(a)(1)(A-E). The Master agreement is attached to this letter and is marked Addendum #1. This Private Letter Ruling request involves periods beginning with and subsequent to the effective date of the Master Agreement, i.e., December 31, 2002. Neither an audit examination nor litigation is pending with the Illinois Department of Revenue ('Department') involving Taxpayer, with respect to the Retailers' Occupation Tax ('ROT') or the ROT issues presented below. We note, however, that the Taxpayer is currently under an Illinois Income Tax audit examination. To the best of our knowledge and that of Taxpayer, (1) the Department has not previously ruled on the same or similar issues presented below for Taxpayer or a predecessor; and (2) neither Taxpayer nor any representative of

Taxpayer has previously submitted the same or similar issues to those presented below to the Department but withdrew them before a letter ruling was issued. Enclosed is a Power of Attorney authorizing FIRM to represent Taxpayer in this matter.

STATEMENT OF FACTS

Taxpayer entered into the Master Agreement with LICENSOR. Taxpayer and licensor have a long-term contract/relationship for the license of engineering software. Taxpayer is a general contractor that uses the engineering software in the performance of contracts with its customers. 'Affiliates' (as defined in the Master Agreement) and other subcontractors are permitted restricted use of the software (as outlined in the Master Agreement) to assist Taxpayer in meeting its contract obligations. The Master Agreement is expressly intended to supersede and replace all prior software license agreements. The Master Agreement between Taxpayer and the Licensor includes terms and conditions set forth in an addendum to the Master Agreement (titled 'Exhibit A'). The terms of the Master Agreement modify the terms of Exhibit A. Exhibit A is attached hereto as Addendum #2. The Master Agreement was amended on September 30, 2003 and again on March 31, 2004 (attached hereto as Addendum #3 and #4, respectively.)

RULINGS REQUESTED

I The Master Agreement satisfies the conditions set forth in 86 Ill. Adm. Code §§ 130.1935(a)(1)(A-E) and, thus, is a license of software that is not a taxable retail sale for purposes of the Retailers' Occupation Tax.

II The Master Agreement, as amended on September 30, 2003, satisfies the conditions set forth in 86 Ill. Adm. Code §§ 130.1935(a)(1)(A-E) and, thus, is a license of software that is not a taxable retail sale for purposes of the Retailers' Occupation Tax.

III The Master Agreement, as amended on March 31, 2004, satisfies the conditions set forth in 86 Ill. Adm. Code §§ 130.1935(a)(1)(A-E) and, thus, is a license of software that is not a taxable retail sale for purposes of the Retailers' Occupation Tax.

RELEVANT AUTHORITY

Illinois regulation, 86 Ill. Adm. Code § 130.1935 states that:

(a) Computer software means all types of software including operational, applicational, utilities, compilers, templates, shells and all other forms. Canned software is considered to be tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means or other media. The sale at retail, or transfer, of canned software intended for general or repeated use is taxable, including the transfer by a retailer of software which is subject to manufacturer licenses restricting the use or reproduction of the software.

(1) 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 of 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.

STATEMENT OF AUTHORITIES SUPPORTING TAXPAYER'S VIEWS

The taxpayer is unable to locate any authority contrary to its views.

DISCUSSION

I *Whether the Master Agreement satisfies the conditions set forth in 86 Ill. Adm. Code §§ 130.1935(a)(1)(A-E) and, thus, is a license of software that is not a taxable retail sale for purposes of the Retailers' Occupation Tax.*

The Master Agreement must satisfy each of the five conditions outlined in 86 Ill. Adm. Code § 130.1935(a)(1) to qualify as a non-taxable license of software. In the sections that follow, we have applied each condition of 86 Ill Adm. Code § 130.1935(a)(1)(A-E) ('Software Regulation') to the applicable, referenced provisions of the Master Agreement.

(A) It is evidenced by a written agreement signed by the licensor and the customer.

Section 5 'Contract Execution' requires the signature of both parties for the license agreement to be valid. The Master Agreement is written and signed by the Licensor and the Taxpayer and, therefore, the first condition (A) of the Software Regulation is satisfied.

(B) It restricts the customer's duplication and use of the software.

1. Duplication

The following sections restrict the Taxpayer's duplication of the software.

- Master Agreement

- Section 4.2 – Token limits
- Section 4.4 – Copies limited to license restrictions

- Exhibit A
  - Section 2.2 – Permission to make only one back-up or archival copy

2. Use

The following sections restrict the Taxpayer's use of the software.

- Master Agreement
  - Section 4.2 – Usage log required
  - Section 4.8 – Use restricted to specific development
  - Section 4.9 – Emergencies: non-designated computers
  - Section 4.12.1 – Use restricted to employees, affiliates and contractors
  - Use restricted to designated computers
  - Use with on-line applications prohibited
  - Service Bureau, ASP or time-sharing use prohibited

- Exhibit A
  - Section 2.3 – Modifications or enhancements to the software prohibited
  - Section 2.4 – Proper use of software
  - Section 2.5 – Reverse engineering prohibited

The Master Agreement, through the above-listed provisions, restricts both the duplication and use of the software and, therefore, the Software Regulation's second condition (B) is satisfied.

(**C**) **The Master Agreement prohibits the Taxpayer from licensing, sublicensing or transferring the software to a third party (except to a related party) without permission and continued control of the licensor.**

<u>General Licensing, Sublicensing or Transferring Restriction</u>

- Section 4.12.10 [replaces Exhibit A Section 13.2] provides:

Section 13.2 [of Exhibit A] is modified by replacing it in its entirety with the following:' Customer shall not assign, sublicense or otherwise transfer all or part of the Software or Proprietary Information to a third party (except as specified in section 2.1 [of Exhibit A as amended by Section 4.12.1, which is discussed in detail below]), grant others rights in all or part of the Software or Proprietary Information, or otherwise assign its rights or obligations under this Agreement without the permission and continued control of [Licensor] and the prior written consent of [Licensor]. For purposes of this section, an assignment or transfer shall include any change in majority ownership or control of Customer, including merger or

other transfer of voting securities. For clarification purposes, [Licensor] agrees that in the event of such change in majority ownership or control of Customer, that Customer may nonetheless continue to use the Software licensed hereunder in accordance with the terms herein, provided that such change in majority ownership or control of Customer will not be construed to expand the scope of the rights set forth in this Agreement beyond the acquired entity to any parents, subsidiaries, affiliates, facilities or sites of such acquirer.'

Section 4.12.10 Analysis – General Restrictions

Section 4.12.10 prohibits the Taxpayer from assigning, sublicensing, otherwise transferring or granting rights to others in all or part of the software or proprietary information to a third party without the express permission, continued control and prior written consent of the Licensor. Thus, the assigning, sublicensing and/or transfer of the software is generally prohibited. This provision provides that any exception must receive both the permission and continued control licensor, which is permitted by the Software Regulation's third condition. Thus, this provision satisfies the requirements of third condition.

An exception to the general prohibition contained in Section 4.12.10 is Section 2.1 of Exhibit A (as amended by Section 4.12.1 of the Master Agreement), which is discussed in the next section.

<u>Exceptions to General Licensing, Sublicensing or Transferring Restriction</u>

- Section 4.12.1 [replaces Exhibit A section 2.1] provides:

Section 2.1 [of Exhibit A] is modified by deleting the existing wording therein, and replacing it with the following new wording: 'Subject to the terms and conditions of this Agreement, TAXPAYER grants and Customer accepts a personal, non-exclusive, non-transferable, revocable license to use the Software at any Customer site during the term of this Agreement only on the Designated Computer(s) by employees of Customer or Customer's Affiliates. For the purposes of this Agreement, 'Affiliates' means, as of the Effective Date of this Agreement, (i) any company or joint venture in which Customer holds at least a fifty percent (50%) ownership interest, or (ii) any company or joint venture in which Customer holds a minority ownership interest, and which TAXPAYER and Customer agree shall be treated as an Affiliate hereunder. For the purposes of this Agreement, 'Related Parties' will be equivalent to Affiliates. Affiliates using the Software agree to comply with the terms of this Agreement. The Customer may allow third party contractors to access and use the Software for the benefit of Customer or its Affiliates, provided that such contractors are under the direct control or supervision of Customer, and Customer guarantees that any use of the Software by such contractors shall be in compliance with the terms of this Agreement (emphasis added). The Customer shall not permit any other person or entity to access and use the Software. The Customer is not permitted to use the Software for on-line applications unless specified in writing. The Software may not be used on a service bureau, ASP, or time-sharing basis without

written consent from TAXPAYER' except that the software may be used by Customer for its customers on Taxpayer developed flowsheets that have been published using TAXPAYER models.

Section 4.12.1 *Analysis*

Section 4.12.1 provides that the software license is non-transferable. In this section, Licensor expressly gives permission to the Taxpayer ('Customer') to allow employees of the Taxpayer or its 'affiliates' (as that term is defined above) to use the software only if (l) the use is on 'designated computers' and (2) affiliates using the software agree to comply with the terms of the Master Agreement. Additionally third party contractors (which are, in fact, subcontractors that are assisting Taxpayer, the general contractor, in performing its contract obligations) may access and use the software if (1) the use is for the benefit of the taxpayer; (2) the contractor is under the direct control or supervision of the taxpayer; and (3) the Taxpayer guarantees that the use of the software by such contractors is in compliance with the terms of the Master Agreement. This section of the Master Agreement generally prohibits the transfer of the software to a third party.

With respect to the permitted use by Affiliates and Contractors as described above, such use, when viewed in light of the significant restrictions/limitations on that use, could not be deemed to be a license or sublicense of the software, nor should the permitted use be deemed to be a transfer of the software. The licensor uses the term 'non-transferable' when referring to the Taxpayer's rights under software license but specifically allows some restricted 'uses' by (not transfers to) third parties. Thus, the licensor gives recognition to the distinction between a software transfer and a software use. Furthermore, the language in the software regulation also gives recognition to the distinction of the term use. The Software Regulation, in the second condition requires restrictions specifically on the 'use' of the software while the third condition does not prohibit the 'use' of the software by third parties. Rather, the Software Regulation generally prohibits (with its exceptions) the 'transfer' of the software to third parties. Thus, this section should not violate the Software Regulation's third condition because there are no transfers of the software to third parties.

Even if the 'use' by Affiliates and Contractors (as defined above) is deemed to be a transfer, the permitted 'use' falls within the permitted exceptions to the general rule, i.e., (1) the exception for a related party, and (2) where the permission is given and continued control is maintained by the licensor. First, with respect to Affiliates, the express language of the agreement provides that 'Related Parties' are equivalent to 'Affiliates.' The third condition permits transfers to a 'related party' without, however, providing a definition to the term. We were unable to locate authority that provided further guidance on the term 'related party' as it pertains to the Software Regulation. Thus, the use by 'affiliates' may be permitted under the related party exception. Second, even if 'Affiliates' as defined above are deemed not to be 'related parties,' the permitted 'use' here for both 'Affiliates' and Contractors is effectuated by the express permission of the licensor as contained in the Master Agreement and the licensor requires that both the Affiliates and Contractors must use the software in compliance with the terms of the Master Agreement thereby maintaining continued control. Thus, the 'use,' to

the extent deemed to be a 'transfer' is with permission and continued control of the licensor and, therefore, the third condition of the Software Regulation is not violated.

- Section 4.16 [replaces Exhibit A section 2.1] provides:

> [Licensor] acknowledges receipt of a fully executed copy of the Export Assurance Letter (attached hereto as Schedule A) to [Licensor], containing the signature of Mr. A and Mr. S from the INSTITUTE Departments only, referenced to herein as 'INSTITUTE'. Customer may allow employees solely of INSTITUTE to utilize the Software Products licensed herein solely for assisting Customer with Customer's internal projects. Customer warrants and represents that INSTITUTE will abide by the terms of this Amendment and that INSTITUTE will not allow employees or representatives from other departments within the INSTITUTE access to or use of the Software Products, including but not limited to the Departments of Physics, Aerospace Engineering, and Space Technology Cell.

Section 4.16 *Analysis*

Section 4.16 provides that Taxpayer can allow INSTITUTE employees to utilize, i.e., use, the software only if (l) the use is solely for assisting Taxpayer with its internal projects; and (2) Taxpayer guarantee that (i) INSTITUTE will abide by the terms of the Master Agreement; and (ii) INSTITUTE will not allow employees or representatives from departments other than Chemical Engineering and Computer Aided Design Centre Departments to access or use the software.

As discussed in the preceding analysis section, the allowed 'utilization' or 'use' by INSTITUTE of the software should not be deemed to be a 'transfer' of software. Furthermore, to the extent that the use is deemed to be a transfer, the licensor has given express permission for INSTITUTE to use the software and requires that INSTITUTE abide by the terms of the Master Agreement thereby maintaining continued control. Thus, the third condition of the Software Regulation is not violated.

- Section 4.22 [replaces Exhibit A section 2.1] provides:

> Customer may allow employees of ABC to utilize the Software Products licensed herein solely for assisting Customer with Customer's internal projects. Customer warrants and represents that ABC will abide by the terms of this Agreement.

Section 4.22 *Analysis*

Section 4.22 provides that Taxpayer can allow ABC employees to utilize, i.e., use, the software only if (1) the use is solely for assisting Taxpayer with its internal projects; and (2) Taxpayer guarantees that ABC will abide by the terms of the Master Agreement.

As discussed above in the 'Section 4.12.1 Analysis' section, the allowed 'utilization' or 'use' by ABC of the software should not be deemed to be a 'transfer' of software. Furthermore, to the extent that the use is deemed to be a transfer, the licensor has given express permission for ABC to use the software

and requires that ABC abide by the terms of the Master Agreement thereby maintaining continued control. Thus, the third condition of the Software Regulation is not violated.

Summary Analysis – Exceptions to General Restriction

The terms of the Master Agreement prohibit the license, sublicense or transfer of the software to a third party. The licensor has permitted certain 'Affiliates,' contractors and third parties to use the software. Such use is not a license or sublicense of the software and should not be deemed to be a 'transfer' of the software for purposes of the Software Regulation's third condition. With respect to the exceptions for affiliates, third party contractors, INSTITUTE and ABC (provided in Sections 4.12.1, 4.16 and 4.22, (1) the Licensor has given express, written permission for such use in the Master Agreement; and (2) there is continued control by the licensor because the affiliates, third party contractors, INSTITUTE and ABC must comply (as guaranteed/warranteed by the Taxpayer) with the terms of the Master Agreement. Furthermore, the use of the software by the affiliates, third party contractors, INSTITUTE and ABC must be solely for the benefit of the Taxpayer. Thus, the third condition (C) of the Software Regulation is satisfied.

(D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or of permitting the licensee to make and to 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.

Sections 2.2 [Exhibit A] and 5.1 [Exhibit A, as amended by Section 4.12.4] of the Master Agreement expressly allow for Taxpayer to make and keep an archival copy of the software. The fourth condition (D) of the Software Regulation is, therefore, satisfied.

(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.

Section 5.1 of Exhibit A provides, in part:

> Upon expiration or termination of a license, Customer's right to use the Software licensed thereunder shall end and Customer shall: (i) promptly return all Software and [Licensor] confidential information and all copies thereof to [Licensor]; (ii) erase all Software from the memory of computer(s) and storage devices or render it non-readable; and (iii) upon LICENSOR's request, certify in writing that Customer has satisfied its obligations hereunder.

This section clearly satisfies the fifth condition (E) of the Software Regulation.

CONCLUSION - I

The Master Agreement, having satisfied all five conditions outlined within Illinois Regulation 86 Ill. Adm. Code § 130.1935(a)(1), qualifies as a license of software that is not a taxable retail sale for purposes of the Retailers' Occupation Tax.

II *Whether the Master Agreement, as amended on September 30, 2003, satisfies the conditions set forth in 86 Ill. Adm. Code §§ 130.1935(a)(1)(A-E) and, thus, is a license of software that is not a taxable retail sale for purposes of the Retailers' Occupation Tax.*

The Master Agreement, as amended on September 30, 2003, must satisfy each of the five conditions outlined in 86 Ill. Adm. Code § 130.1935(a)(1) to qualify as a non-taxable license of software. We incorporate the discussion in Part I above into this Part II. Additionally, we have applied each condition of 86 Ill. Adm. Code § 130.1935(a)(1)(A-E) to the amending provisions to the extent we have deemed such provisions relevant to determining whether the Master Agreement, as amended, qualifies as a non-taxable license of software.

(A) It is evidenced by a written agreement signed by the licensor and the customer.

The amended provisions are written and Section 4 requires the signature of both the Licensor and the Taxpayer. The amendment has been properly executed. Therefore, the first condition (A) of the Software Regulation is satisfied.

(B) It restricts the customer's duplication and use of the software.

1. Duplication

The following section(s) of the September 30, 2003 amendment further restrict the Taxpayer's duplication of the software.

- Section 3.1 – Internet security key

2. Use

The following section(s) of the September 30, 2003 amendment further restrict the Taxpayer's use of the software.

- Section 3.1— Internet security key
- Section 3.3 – Training

The Master Agreement (as amended) restricts both the duplication and use of the software and, therefore, the Software Regulation's second condition (B) is satisfied.

(C) It prohibits the Taxpayer from licensing, sublicensing or transferring the software to a third party (except to a related party) without permission and continued control of the licensor.

Section 3.3 of the amendment provides, in part:

> Upon prior written consent fom [Licensor], Customer may provide such training to third party clients who are not a licensee of the Engineering Software, at such client's site, with the Engineering Software provided by Customer to be loaded on the third party's hardware. The Engineering Software shall not be used in this training capacity to perform actual design work or further consulting services, nor to address specific problems of its third party clients. *** Customer acknowledges that the use of the Engineering Software for training purposes granted by this clause shall be on an 'As Is' basis, that Customer's clients shall not be permitted to remove the Engineering Software from the Customer locations, and [Licensor] assumes no responsibility for the content or outcome of any training course using the Engineering Software. Further, Customer ensures that it shall remove all copies of the Engineering Software loaded on its client's machines at the conclusion of each training course, and shall use all reasonable measures to prevent any unauthorized duplication of the Engineering Software by its clients.

Analysis

> The software, when loaded onto third parties' computers by Taxpayer, is not permitted to leave the Taxpayer's premises and may only be used in a training environment. The software must not be used to perform actual design work or further consulting services, nor address specific problems of the third parties and it must be deleted from the third parties' computers upon completion of the training. Such limited access to the software should not be considered a transfer of software. To the extent that loading software on third parties' hardware, for the purpose of providing training to the third parties on the Taxpayer's premises, is deemed to be a transfer, such transfer is permissible because it requires the prior written consent of the Licensor and is subject to the Licensor's express restrictions on use of the software. Therefore, the Master Agreement (as amended) satisfies the Software Regulations third requirement (C).

(D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or of 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.

> The amendment does not include provisions that affect the analysis of Part I above. Therefore, the Master Agreement (as amended) satisfies the Software Regulation's fourth requirement (D).

(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.

The amendment does not include provisions that affect the analysis of Part I above. Therefore, the Master Agreement (as amended) satisfies the Software Regulation's fourth requirement (D).

CONCLUSION – II

The Master Agreement, as amended on September 30, 2003, having satisfied all five conditions outlined within Illinois Regulation 86 Ill. Adm. Code 130.1935(a)(1), qualifies as a license of software that is not a taxable retail sale for purposes of the Retailers' Occupation Tax.

III *Whether the Master Agreement, as amended on March 31, 2004, satisfies the conditions set forth in 86 Ill. Adm. Code §§ 130.1935(a)(1)(A-E) and, thus, is a license of software that is not a taxable retail sale for purposes of the Retailers' Occupation Tax.*

The Master Agreement, as amended on March 31, 2004, must satisfy each of the five conditions outlined in 86 III Adm. Code § 130.1935(a)(1) to qualify as a non-taxable license of software. We incorporate the discussion in Parts I and II above to this Part III. Additionally, we have applied each condition of 86 III Adm. Code § 130.1935(a)(1)(A-E) to the amending provisions to the extent we have deemed such provisions relevant to determining whether the Master Agreement, as amended, qualifies as a non-taxable license of software.

(A) It is evidenced by a written agreement signed by the licensor and the customer.

The amended provisions are written and Section 4 requires the signature of both the Licensor and the Taxpayer. The amendment has been properly executed.

(B) It restricts the customer's duplication and use of the software.

Use

The following section(s) of the September 30, 2003 amendment further restrict the Taxpayer's use of the software.

- Section 3.3 – Access and usage restricted for certain companies, joint ventures and third parties.

The Master Agreement (as amended) restricts both the duplication and use of the software and, therefore, the Software Regulation's second condition (B) is satisfied.

(C) It prohibits the Taxpayer from licensing, sublicensing or transferring the software to a third party (except to a related party) without permission and continued control of the licensor.

Section 3.1 of the amendment provides, in part:

> In consideration of [Licensor's] granting of the licenses herein, Customer [Taxpayer] agrees that the third and fifth sentences of note 4.12.1 of the Token Agreement shall not apply to the licenses shown in Section 1 above, provided however, that Customer may nonetheless allocate and provide access to the Software Products, under the terms hereof, to not more that 500 persons not employees of Customer who (A) are under contract with the Customer to perform services for Customer on behalf of customer in such manner and as if such person were in the direct employ of customer, (B) are not directly or indirectly engaged in development, sale, marketing or provision of services (whether deployment, modeling, consultation or otherwise) relating to software competitive with all or part of any part of TAXPAYER's Software, an (C) prior to allocation or access to the Software Products, Such persons execute the form NDA [Non-Disclosure Agreement] attached hereto … which shall be accepted and counter-executed by TAXPAYER.

Analysis

With respect to the product software licenses specified in the March 31, 2004 amendment, Section 3.1 first modifies Section 4.12.1 of the Master Agreement by eliminating the following provisions (third and fifth sentences):

> For the purposes of this Agreement, 'Related Parties' will be equivalent to Affiliates. *** The Customer may allow third party contractors to access and use the Software for the benefit of Customer or its Affiliates, provided that such contractors are under the direct control or supervision of Customer, and Customer guarantees that any use of the Software by such contractors shall be in compliance with the terms of this Agreement, (emphasis added).

Thus, Section 4.12.1 no longer provides authorization for Taxpayer to provide access to the referenced product software to 'Related Parties' or third party contractors. Section 3.1, however, authorizes Taxpayer to provide third party contractors (limited to 500 persons) with access to the software, provided the individuals: (1) are performing services on behalf of Taxpayer as if the individual were in the direct employ of the Taxpayer; (2) are not developers or marketers of software that is in competition with Licensor's software; and (3) prior to being granted access to the software, execute a Non-Disclosure Agreement ('NDA').

The access to the software authorized by Section 3.1 is permissible under 86 III Adm. Code § 130.1935(a)(1)(C). Under the same reasoning utilized for Section 4.12.1 (above) where we concluded that a 'use' should not be deemed to be a 'transfer,' providing restricted 'access' to the software similarly should not be deemed to be a transfer and, thus, the Software Regulation's third condition (C) should not be violated. To the extent that the granting of such access is deemed to be a transfer of the software, the Licensor, in Section 3.1, expressly grants permission to Taxpayer to grant such access. Furthermore, prior to being granted access to the software, the third party must execute a NDA. The NDA, which is counter-executed by the Licensor, also serves as the Licensor's grant of permission to access the software. The NDA provides several software

access/usage restrictions as well as providing that the permitted access to and usage of the software (1) shall be solely for the benefit of Taxpayer; (2) does not constitute a license of the software; and (3) shall be strictly in accordance with all terms and provisions of the [Master Agreement]. Thus, the third party access/usage provided in Section 3.1 is with the permission and continued control of the licensor. Therefore, the third condition (C) of the Software Regulation is satisfied.

(D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or of 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.

The amendment does not include provisions that affect the analysis of Part I or II above. Thus, the fourth condition (D) of the Software Regulation is satisfied.

(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.

The amendment does not include provisions that affect the analysis of Part I or II above. Thus, the fifth condition (E) of the Software Regulation is satisfied.

CONCLUSION – III

The Master Agreement, as amended on March 31, 2004, having satisfied all five conditions outlined within Illinois Regulation 86 Ill. Adm. Code § 130.1935(a)(1), qualifies as a license of software that is not a taxable retail sale for purposes of the Retailers' Occupation Tax.

* * *

We previously met with PERSON, on an informal basis, to discuss the issues that are presented in this Private Letter Ruling request. PERSON reviewed the Master Agreement, indicated that she conferred with her supervisor, and provided guidance that the Master Agreement would satisfy the requirements for a non-taxable license of computer software. We understand that such verbal and informal guidance is not binding on the Department. If, however, the Department tentatively concludes that the Master Agreement does not satisfy the requirements of a non-taxable license of software, we respectfully request an opportunity to discuss the issues with the appropriate Department representative(s) prior to the issuance of the ruling.

An electronic version of this private letter ruling request is available upon request. We request that any references to TAXPAYER, LICENSOR, INSTITUTE, and ABC, be excluded from any public releases of this letter.

Please contact me if you have any questions, or require additional information or, for any reason, tentatively determine that you cannot issue the requested ruling.

DEPARTMENT'S RESPONSE

As set forth in the Department's regulation for computer software at 86 Ill. Adm. Code 130.1935(a)(1)(A-E), "[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 of 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 boos 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.

Based upon the information provided in the request for a Private Letter Ruling, the Master Agreement (Addendum #1), Exhibit A (Addendum #2), the September 30, 2003 Amendment (Addendum #3), and the March 31, 2004 Amendment (Addendum #4), our rulings are as follows:

Ruling 1 - The Master Agreement (Addendum #1), including modifications to Exhibit A (Addendum #2), satisfies the conditions set forth in 86 Ill. Adm. Code 130.1935(a)(1)(A-E) and thus, is a license of software that is not a taxable retail sale for purposes of the Retailers' Occupation Tax.

Ruling 2 - The Master Agreement as amended on September 30, 2003, qualifies as a license of software and is not a taxable retail sale for purposes of the Retailers' Occupation Tax. Although Section 3.3 of the September 30, 2003 amendment (Addendum #3) provides for the use of the software by the licensee's third party clients at the client's site, such use may be made only upon the prior written consent of the licensor and only under very limited and controlled conditions. Such limited access is not deemed to be a transfer of software. However, even if such limited access were deemed to be a transfer of software, the transfer is made only upon the prior written consent of the licensor and under limited conditions set forth and agreed to by both the licensor and the licensee, in accordance with Section 130.1935(a)(1)(C) of the regulation.

Ruling 3 - The Master Agreement as amended on March 31, 2004, qualifies as a license of software and is not a taxable retail sale for purposes of the Retailers' Occupation Tax. Although Section 3.1 of the March 31, 2004 amendment (Addendum #4) provides for the use of the software by 500 persons not employees of the licensee, such use is authorized by the licensor under Section 3.1 and is authorized under limited conditions set forth and agreed to by both the licensor and licensee. The users must be under contract with the licensee to perform services for the licensee on behalf of

the licensee in such a manner and as if such users were in the direct employ of the licensee, the users may not be directly or indirectly engaged in the development, sale, marketing or provision of services relating to software competitive with LICENSOR's PRODUCT, and prior to access to the software products, the users must execute a Non-Disclosure and Development Restriction Agreement as set forth in the March 31, 2004 amendment.

You have indicated that the Taxpayer is currently under an Illinois Income Tax audit examination. This PLR binds the Department only in regard to the sales tax issues presented in your letter.

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 in the factual representations recited in this ruling.

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.

Very truly yours,

Martha P. Mote
Associate Counsel

MPM:msk
Enc.