

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

August 23, 2010

Dear Xxxxx:

This letter is in response to your letter dated May 17, 2010, 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](http://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:

This letter represents a request for a written ruling or interpretation from your State on the application of sales tax in the situations enumerated here below.

Illustrative Facts:

(01) Client Company, "The Company", provides hosted marketing services to clients that use email, direct mail, and other marketing channels to reach their customer bases. Serving various industries, the company's branded software and related services help clients evaluate their potential and existing customers and then plan and implement marketing campaigns; because its software platform is hosted, it can easily apply its software to different types of clients or adapt it to existing clients' changing needs. The Company's clients include Airlines, Hotels, Retail Sales Stores, Auto Rental companies and a host of other Commercial and Retailing establishments. The Company enables its customers to increase revenue and customer engagement through successful email and cross-channel marketing.

(02) The Company is headquartered in STATE where all of its product development and hosting is performed. The Company has sales people in various states, including your, [sic] who work out of the Company Office in your State, solicit sales and forward the same to the company headquarter [sic] for acceptance.

(03) The Company has developed a proprietary program 'PROGRAM' that allows customers to create, manage and deliver email campaigns. The Company's software enables users to take information that they accumulate on their customers or prospects (such as their email address, demographic data, web browsing history and any other data about the customer) and apply search criteria against that information to derive a list of targeted recipients to whom a message is to be sent. Using the Customers [sic] documents and marketing materials ('Content'), a customized message can then be sent to each of the targeted recipients. Customers load their own content and data into a storage area onto computer storage the company maintains in its data centers. The software matches the content for each recipient based on the criteria that the Customer has entered into the software. The software then compiles the message and sends the message to the recipient. Customers load their own Content and data via the Internet and their data is kept separate from any data belonging to other Customers of the Company. The software does track the history and activity of emails that Customers send, which is stored and made available to the Customer via web access. **The Company does not sell or provide marketing data. The Customer cannot download any of the SOFTWARE to perform the functions on their own computers.**

(04) Customers of the Company use the PROGRAM to send targeted emails to their prospects and customers. Emails are compiled from content and data that the Customer owns and stores either in its own systems or on computers in the Company's data center. The Company never owns the data. That content and data is then compiled in a way that customized messages are sent to the recipients based on marketing campaigns or other types of communications the Customer wants to execute. While the vast majority of messages are sent via email, they can also be sent to a mobile device (e.g. cell phone or smart phone) or posted to a social site that the customer maintains. Via the web access, Customers are able to monitor activity on campaigns they have sent out, run reports on these campaigns and plan future campaigns.

(05) The messages are sent out of the Company's servers/data centers that are located in STATE. The data centers host all of the software developed by the company, contain all of the electronic storage where the data belonging to Customers is maintained and houses all the hardware, software and communications infrastructure to send out high volumes of messages. The equipment in these data centers also track message activity, or in other words all of the events that have to message once it has been sent (open rates, bounce rates etc). Any data a Customer may keep in the system is stored in these data centers. Employees of the Customers use the PROGRAM via a website that they log into. These employees may be located in any location. For example, Customer X based out of Texas has an employee in Arizona that logs into a website to use the PROGRAM located in STATE. The employee could be located anywhere in the world and be able to access the PROGRAM as long as they have an Internet connection.

(06) Subject to the payment of fees the Company grants to its customer an unconditional and irrevocable non-exclusive, non-transferable License to use this proprietary program for designated number of interactive users. Title to and ownership of the License and all its proprietary items remain with the Company and no downloads of the proprietary program is allowed to the customer's computers. The agreement is only for service.

The customer is charged the following fee depending on the customer order:

Set-Up Fee – for the initial setup of the Customer to enable them to use the SOFTWARE.

Messaging Fee – charge to send messages. Customers pay for use of the PROGRAM based on the volume of messages committed or actually sent if the commitment is exceeded. The Company offers various package programs to its Customers. This constitutes 80% of the company business.

Consulting Service Charges that include (i) training on use of the PROGRAM, (ii) consulting on best practices, (iii) creative services to design messages and (iv) services to help execute campaigns. Charges for these services are based on the type of service and are either hourly or fixed rate. These services are primarily delivered out of the Company offices in STATES via the Internet.

(07) The Company does not provide any tangible deliverables in to any state. The Customer uses the PROGRAM to their targeted customers via emails who may be located in the US or any part of the world. Customer's employee may access the Internet from any location in the US (or the world) to work on the PROGRAM that is on a server located in STATE. It is not possible for the Company to identify the number of messages sent to any given state in the US. Invoices are based on the Bill-to location of the Customer.

**Questions:**

(1) Is the company required to register for Sales Tax in your State, even if the Company has resident sales people soliciting orders in your State, given that the Company only provides services to its Customers, of the nature described above and provides no tangibles?

(2) The Company's customers remotely access the Company's server (via the Internet) that is physically located in STATE. The SOFTWARE on the Company's server that a customer uses to create, manage and deliver email campaigns cannot be downloaded on to the customer's computer. Will your State consider such activity as a taxable event in your State?

Will the answer change if the Company's PROGRAM and software was on a server that was located in your State?

(3) Is the Set-Up Fee taxable in your State? This is a one-time charge for the initial on-line setup to enable the Customer to use the SOFTWARE. The Company does not provide on-site installations and no tangibles are delivered for the set-up.

(4) Is the Messaging Fee charged by the Company taxable in your State? There are no tangible deliverables that the Company provides to its customers in your State. The Company's customers use the company software on its server located in STATE to send email messages to its targeted customers. The targeted customer can be in any part of the country/world. The Company does not monitor the location of its customer's targeted customers.

If taxable, is there an allocation basis if there is a way to determine the State of the targeted customers of the Company's customer?

If taxable, is there a special tax rate for such transactions? Is the tax rate based on the Bill-to customer location that includes state, county, city, district and other local taxes?

(5) The Company bills its customers based on the billing location address (since there are not tangibles delivered in your state). If the Messaging Fee is taxable in your State will the answer change if the Company's employees reside in another State and access the PROGRAM from outside your State?

(6) Is Consulting Service Charge taxable in your State? The Company offers professional services that include (i) training on use of the PROGRAM, (ii) consulting on best practices, (iii) creative services to design messages and (iv) services to help execute campaigns. Charges for these services are based on the type of service and are either hourly or fixed rate. These services are delivered out of the Company offices in STATES via the Internet.

Please provide the taxability rules for these services in your state. Does it make any difference if the charges are bundled or not?

A prompt response will be greatly appreciated. If you have any question(s), please contact me.

## **DEPARTMENT'S RESPONSE:**

General information letters are used to direct taxpayers to the Department's regulations and other sources of information for general guidance. You may find the Department's general information letters helpful in regards to many of the issues raised in your request. The Department's "Sunshine Letter" rulings are located on the Department's Internet website under the heading of "Laws/Regs/Rulings."

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 do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, 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. Services that involve the transfer of tangible personal property (such as, for example, written reports, other tangible media and training manuals) incident to a sale of service may be subject to either Service Occupation Tax liability or Use Tax liability.

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, canned computer software is considered taxable tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means or other media. See

86 Ill. Adm. Code 130.1935. If the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See Section 130.1935(c).

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See Section 130.1935(c)(3).

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or 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 acceptance of a software license agreement by clicking "accept" while online is not considered "acceptance" sufficient enough to constitute a written agreement signed by the licensor and the customer for purposes of subsection (a)(1)(A) of Section 130.1935. 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 agreement would be taxable as sales of canned software.

Assuming that any services provided, such as installation, phone support, training, and seminars, do not require the transfer of tangible personal property to the recipients of those services, charges for such services are exempt if they are separately stated from the selling price of canned software. See Section 130.1935(b). If computer software training or other support services are provided in conjunction with a sale of custom computer software or a license of computer software, the charges for that training are not subject to tax.

Please note that the Department has determined that the proper forum to determine the appropriate taxation of computer software Application Service Providers (ASPs), software hosting and web-based software is through a formal administrative rulemaking process rather than on a case-by-case basis through individual inquiries.

I hope this information is helpful. If you require additional information, please visit our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

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Associate Counsel

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