

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

December 14, 2010

Dear Xxxxx:

This letter is in response to your letter dated September 9, 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:

After carefully reviewing the relevant state codes and regulations we remain unclear as to the application of sales tax on certain products currently available for sale in our retail stores located throughout the state as well as on our website. We are seeking guidance on the following product classes. Specific examples of representative products have been cited for reference:

- 1) Remote Access Software / Virtual Goods – the purchase by retail consumers of digital content for use in an online video game. The virtual goods are accessed by customers online and typically involve either accessing a complete game or accessing additional content within a game that resides on a third party computer server.

ABC sells an access code printed on a paper receipt to individual customers that allows the customer to access the described content on a third party server. ABC will also soon sell such codes via its website and customers would print out or otherwise record the code displayed on screen for later use.

**Please clarify whether or not the sale of such access codes by ABC in a physical retail environment and/or via the Internet is taxable.**

*Examples of products in this category are completely web-based games such as Habbo Hotel, Mafia Wars, Farmville and Yoville and/or in-game content available for use in such online games such as access to pay-only play levels or virtual in-game tools for use in playing an online game.*

- 2) Downloadable Digital Content – the purchase by retail consumers of electronically delivered pre-written software in the form of complete video games or video game add-ons that are downloaded directly to a customer’s personal computer, gaming console, or mobile device.

ABC sells an access code printed on a paper receipt to individual customers that allow the customer to access and download software from a third party server directly to the customer’s device. ABC will also soon sell such codes via its website and customers would print out or otherwise record the code displayed on screen for later use.

**Please clarify whether or not the sale of such access codes by ABC in a physical retail environment and/ or via the Internet is a taxable transaction.**

*Examples of products in this category are the download of entire video games currently offered on disc in a retail store, such as Fallout 3 or Saints Row2, or the download of add-on map packs and play levels, currently offered only via Internet download, that may be integrated into previously purchased video game, [sic] such as map packs offered for Call of Duty or Red Dead Redemption.*

- 3) Subscription Cards – the purchase by retail consumers of plastic cards containing subscription time to be used to access online networks that allow game play, interaction among other players on a network, access to digital online content, or the direct download of digital content to a consumer’s device.

ABC sells plastic cards containing a subscription that allow the customer to access a third party network or content on a third party network for specified [sic] period of time. Cards offering points may provide network access for a period of time, be used to access digital content on the network, or be used to directly download digital content from the network.

**Please clarify whether or not the sale of subscription cards by ABC in a physical retail environment and/or via the Internet is a taxable transaction.**

*An example of a product in this category is the Microsoft Xbox Live Subscription card.*

- 4) Points Cards – the purchase by retail consumers of plastic cards containing point values to be used within online networks for game play, interaction among other players on a network, access to digital online content, or the direct download of digital content to a consumer’s device.

ABC sells plastic cards containing points that allow the customer to access content on a third party network for specified number of points. Cards offering points may provide network access for a period of time, be used to access digital content on the network, or be used to directly download digital content from the network.

**Please clarify whether or not the sale of points cards by ABC in a physical retail environment and/or via the Internet is a taxable transaction.**

*An example of a product in this category is the Microsoft XB360 Live Marketplace Points card.*

- 5) Notional Dollar Value Cards – the purchase by retail consumers of plastic cards containing notional dollar values to be used within online networks for game play, interaction among other players on a network, access to digital online content, or the direct download of digital content to a consumer's device.

ABC sells plastic cards containing notional dollar values that allow [sic] the customer to access content on a third party network for specified number of points. Cards offering points may provide network access for a period of time, be used to access digital content on the network, or be used to directly download digital content from the network.

**Please clarify whether or not the sale of notional dollar value cards by ABC in a physical retail environment and/or via the Internet is a taxable transaction.\***

*An example of a product in this category is the Sony PlayStation Network Card.*

\*We note that Sony currently collects sales tax at the time of card use, as do all current issuers redeeming notional dollar value cards. ABC does not collect sales tax in cases where the issuer collects tax upon card redemption. However, we would still like clarification on taxability should a situation arise in which an issuer does not collect sales tax on the redemption of notional dollar value cards.

We appreciate your assistance and look forward to your written response. Should you require any additional information please contact me.

#### **DEPARTMENT'S RESPONSE:**

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. 35 ILCS 120/2; 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. 35 ILCS 105/3; 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois. If the purchases occur in Illinois, the purchasers must pay the Use Tax to the retailer at the time of purchase. The retailers are then allowed to retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales. If the purchases occur outside Illinois, purchasers must self assess their Use Tax liability and remit it directly to the Department.

Persons who are engaged in the business of selling cards or coupons, which entitle purchasers to the right to redeem those cards for tangible personal property, are not engaged in selling tangible personal property. Rather, they are making sales of intangibles. Such sales are not subject to the Retailers' Occupation Tax. However, when those cards or coupons are used to

purchase tangible personal property, the retailers transferring that tangible personal property incur Retailers' Occupation Tax liability based on their gross receipts from those sales.

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 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.

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.

The Department believes that the proper forum for providing guidance regarding transactions involving computer software Application Service Providers (ASPs), software hosting and web-based software is through a formal administrative rulemaking process rather than through individual inquires such as letter ruling requests. The Department at present is in the process of researching the nature and type of services and products provided in such transactions, including discussions with industry participants. The Department has found, based on the discussions to date and previous letters

received by the Department, that there is no universal agreement regarding the nature of services or products that such sellers provide to their customers. Until the Department has adopted a rule on such transactions, retailers will have to determine, based on the definition contained in Section 2-25 of the Retailers' Occupation Tax Act, whether the products they provide are "computer software.

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,

Richard S. Wolters  
Associate Counsel

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