

This letter concerns sales of software manufacturer agreements. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

August 24, 2011

Dear Xxxxx:

This letter is in response to your letter dated October 5, 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 Department’s regulation “Public Information, Rulemaking and Organization” provides that “[w]hether to issue a private letter ruling in response to a letter ruling request is within the discretion of the Department. The Department will respond to all requests for private letter rulings either by issuance of a ruling or by a letter explaining that the request for ruling will not be honored.” 2 Ill. Adm. Code 1200.110(a)(4). The Department declines to issue a Private Letter Ruling. We are responding instead with this General Information Letter that we hope will assist you.

In your letter you have stated and made inquiry as follows:

ABC respectfully requests the Illinois Department of Revenue to issue a Private Letter Ruling pursuant to 2 Ill. Adm. Code 1200.110 with respect to the below factual situation.

This Private Letter Ruling (‘PLR’) is not requested with regard to hypothetical or alternative proposed transactions. This PLR is requested to determine the Retailers’ Occupation Tax (‘ROT’), consequences of the actual business practices of ABC.

*Information Required by 2 Ill. Adm. Code 1200.110(b)*

1. Compete Statement of Material Facts

ABC sells products that accelerate application performance and data transfer over the wide area network (WAN). These products consist of hardware appliances that are sold with proprietary software embedded in the appliance. The hardware appliance is not sold separately from the software. In conjunction

with the purchase of ABC Steelhead products, customers separately purchase maintenance services. The maintenance service agreement provides for updates of canned software, warranty repairs and technical support. There is not a separate charge for the updates. ABC currently charges ROT on both sales of the appliances and on maintenance for the appliances.

Based on the material facts, we respectfully request a response to the following question:

I. Whether the sale of maintenance services, which include updates for software that would satisfy the conditions set forth in 86 Ill. Adm. Code Sec. 130.1935(a)(1) if it was sold on a stand alone [sic] basis, would be exempt from ROT if the software is embedded and sold in a hardware appliance.

2. All Relevant Documents

See attached 'ABC Maintenance and Support Services' for details regarding ABC's maintenance services.

3. Tax Period Identification and Audit/Litigation Disclosure

ABC is not currently engaged in litigation with the Illinois Department of Revenue (the 'Department') in regard to this or any other tax matter. ABC is not currently under audit by the Department in regard to this or any other tax matter.

4. Taxpayer's Representation Regarding Originality of Request

To the best of ABC's knowledge the Department has not previously ruled regarding this matter for ABC. In addition, Company has not submitted the same or similar issue to the Department.

5. Taxpayer's Analysis

A software license agreement ('Agreement') that satisfies each of the five conditions outlined in 86 Ill. Adm. Code Sec. 130.1935(a)(1) qualifies as a non-taxable license of software. For purposes of this ruling request, it is assumed that the underlying software embedded in the hardware appliance, meets the requirements of 130.1935(a)(1).

Based upon a review of PLRs issued by the Department in regards to software and 86 Ill. Adm. Code Sec. 130.1935(a)(1) it does not appear that a situation similar to ABC's has been addressed, i.e. maintenance for software that would meet the requirements of 130.1935(a)(1), but that is also (1) sold as part of a hardware appliance and that (2) provides updates of canned software.

ABC currently taxes the maintenance on the basis that the maintenance is for both hardware and for software embedded in the hardware and that this, in addition to the provision of software updates, causes it to fall outside the exemption of 86 Ill. Adm. Code 130.1935(a)(1).

6. Statement of Authorities Contrary to Taxpayer's Views

ABC knows of no authority contrary to the authorities referred to and cited above.

7. Request for Deletion of Information

ABC requests that certain information be deleted from the PLR prior to dissemination to others. ABC requests that its name and address be deleted.

8. Taxpayer Signature

See below.

ABC respectfully requests that the Department issue a ruling on the aforementioned question. If the Department cannot conclude that these, [sic] we request that the Department contact ABC to determine what additional information is required or all [sic] the taxpayer to rescind this ruling request.

**DEPARTMENT'S RESPONSE:**

In general, maintenance agreements that cover computer software (i.e. agreements to provide repair service for computer software for a stated period for a predetermined fee) are treated the same as maintenance agreements for other types of tangible personal property. See 86 Ill. Adm. Code 130.1935(b). The taxation of maintenance agreements is discussed in subsection (b)(3) of Section 140.301 of the Department's administrative rules under the Service Occupation Tax Act. See 86 Ill. Adm. Code Sec. 140.301(b)(3). The taxability of agreements for the repair or maintenance of tangible personal property depends upon whether charges for the agreements are included in the selling price of the tangible personal property. If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. In those instances, no tax is incurred on the maintenance services or parts when the repair or servicing is performed. A manufacturer's warranty that is provided without additional cost to a purchaser of a new item is an example of an agreement that is included in the selling price of the tangible personal property.

If agreements for the repair or maintenance of tangible personal property are sold separately from tangible personal property, sales of those agreements are not taxable transactions. However, when maintenance or repair services or parts are provided under those agreements, the service or repair companies will be acting as service providers under provisions of the Service Occupation Tax Act that provide that when service providers enter into agreements to provide maintenance services for particular pieces of equipment for stated periods of time at predetermined fees, the service providers incur Use Tax based on their cost price of tangible personal property transferred to customers incident to the completion of the maintenance service. See 86 Ill. Adm. Code Sec. 140.301(b)(3). The sale of an optional maintenance agreement or extended warranty is an example of an agreement that is not generally a taxable transaction.

If, under the terms of a maintenance agreement involving computer software, a software provider provides a piece of object code ("patch" or "bug fix") to be inserted into an executable program that is a current or prior release or version of its software product to correct an error or defect in software or hardware that causes the program to malfunction, the tangible personal property transferred incident to providing the patch or bug fix is taxed in accordance with the standard maintenance agreement provisions discussed above.

In contrast to a patch or bug fix, if the sale of a maintenance agreement by a software provider includes charges for updates of canned software, which consist of new releases or new versions of the computer software designed to replace an older version of the same product and which include product enhancements and improvements, the general rules governing taxability of maintenance agreements do not apply. This is because charges for updates of canned software are fully taxable as sales of software under Section 130.1935(b). (Please note that if the updates are subject to a license that meets all of the requirements under Section 130.1935(a)(1) they are not taxable). Therefore, if a maintenance agreement provides for updates of canned software, and the charges for those updates are not separately stated and taxed from other maintenance agreement charges, then the whole agreement is taxable as a sale of canned 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.

Sincerely,

Samuel J. Moore  
Associate Counsel

SJM:msk