ST-21-0006 09/09/2021 SERVICE OCCUPATION TAX

This letter discusses the application of Service Occupation Tax when a serviceman does not separately state the price for tangible personal property transferred incident to service. 86 Ill. Adm. Code 140.106. (This is a PLR.)

September 9, 2021

Dear: NAME

This letter is in response to your letter dated June 3, 2021, in which you requested 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 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 COMPANY 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 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:

> Pursuant to Ill. Admin. Code tit. 2, § 1200.110 the Company respectfully submits this request for formal written and binding guidance from the Illinois Department of Revenue ("Department") on the proper application of Retailers' Occupation Tax and/or Service Occupation Tax pertaining to the Company's offering.
>
> The Company is currently registered for Illinois sales and use tax purposes. The Company completed a voluntary disclosure agreement with the State of Illinois for the tax periods between October 1, 2018 to August 31, 2019 and has since been a monthly out-of-state/remote sales tax filer of the Retailers' Occupation Tax. To the best of the Company's knowledge, the Department has not previously ruled on the same or similar issue for the Company, nor has the Company or any

representative previously submitted the same or similar issue to the Department, withdrawing it before a ruling was issued.

The Company shall present the information in the following format:

I. Facts
II. Issue
III. Pertinent Authority
IV. Discussion
V. Ruling Request

I. Facts

The Company is a BUSINESS C-corporation headquartered in CITY, STATE. The Company sells hardware and corresponding software subscriptions. To enter into a contract with the Company for the Company's products and services, the Customer must sign an Order Form, *see* Sample Company Agreement, attached as Exhibit A. The provided Company agreement references the Company's full terms of service found online at WEB PAGE-1 attached as Exhibit B.

The hardware products are internet connected sensors including cameras, GPS fleet trackers, temperature monitors, and driver ID tokens. Cables and other hardware accessories are also included. For hardware products to function, they require an active subscription of a COMPANY "License". The "License" represents a subscription to online cloud services that are enabled by the hardware and firmware as well as the hardware and embedded firmware itself. This includes hosted cloud service, support, software and firmware updates, and cellular connectivity. This includes embedded technology that is unique to the hardware that allows it to store and collect data, that data is captured and sent in real time to an online dashboard. Customers access this online dashboard electronically through computers/tablets/smart phones.

The Company's hardware products do not function with non-Company subscriptions, without both aspects of the sale, the Company is not able to satisfy its performance obligation. Each piece of hardware has firmware (software embedded in or otherwise running on the hardware) embedded on it which is updated regularly by downloads and updates provided as a part of the subscription. These updates significantly impact the functionality of the hardware. The hardware is not useful without the subscription and is not sold without the subscription.

The customer owns the hardware; however, the Company retains ownership of the firmware. Customers cannot install, download, or transfer the firmware or hosted software to their own computers. The subscription has a term of service generally between 3-5 years in length. The customer is not required to return the hardware to the Company once the subscription has expired.

The Company sells the noted products in a bundled offering inclusive of the necessary hardware, cables, and accessories. The hardware is not incidental to the sale, it is a necessary component of our offering. The purchase price is listed next to our license products, but the price is inclusive of the cost of hardware (including warranty) and subscription. Replacement hardware, cables and accessories can be sold separately as needed at list price. COMPANY only separately charges for hardware, cables, and accessories when it is to replace existing items due to damage, loss, etc. In all other instances, the price is listed in total with the license subscription. See sample material on the Company's product offering:

-

WEBPAGE-2
Models & Specs page gives the high level overview with downloadable data sheets on each product.
WEBPAGE-3

Overall, we do not charge separately for hardware components. At original purchase the pricing is viewed as bundled so there may not be a separate charge, but just one singular price charged for the whole purchase. We also have a mandatory warranty built into that purchase price, so warranty replacements are also covered in the purchase price. This can be found in our COMPANY Terms of Service as noted above. Our Terms of Service states a charge for "License," this is representing a subscription to online cloud services that are enabled by the hardware and firmware as well as the hardware and embedded firmware. This then also includes any subsequent updates to the firmware and software. There is no separate subscription charge, the "License" charge is the subscription and hardware charges.

.

ll. Issue

Whether the Company's provision of hardware and software subscriptions as presented are subject to Illinois' Retailers' Occupation Tax, Use Tax, Service Occupation Tax or Service Use Tax.

III. Pertinent Authority

Illinois Sales and Use Tax

The Retailers' Occupation Tax (ROT) imposes a tax upon persons engaged in Illinois in the business of selling tangible personal property to purchasers for use or consumption.[1] The Use Tax (UT) is a complementary privilege tax imposed on the privilege of using tangible personal property in Illinois, which is purchased at retail.[2] "Sale at retail" means "any transfer of the ownership of or title to tangible personal property to a purchaser, for the purpose of use or consumption."[3]

The Service Occupation Tax (SOT) imposes a tax upon persons engaged in Illinois in the business of making sales of service, based on tangible personal property transferred incident to sales of service.[4] The purchase of tangible personal property that is transferred to the service customer may result in either Se r vice Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities.[5] The serviceman's liability may be calculated in one of four ways:

1) separately-stated selling price of tangible personal property transferred incident to service;
2) 50% of the serviceman's entire bill;
3) Service Occupation Tax on the serviceman's cost price if the serviceman is a registered de minim is serviceman; or
4) Use Tax on the serviceman's cost price if the serviceman is de minimis and is not otherwise required to be registered under Section 2a of the Retailer s' Occupation Tax Act.[6]

The Service Use Tax (SUT) is a complementary privilege tax imposed on the privilege of using in Illinois real or tangible personal property that is acquired as an incident to the purchase of a service.[7]

Computer Software
In Illinois, computer software (other than custom software) is included within the statutory definition of "tangible personal property" and its sale or use is taxable.[8] Canned software is considered to be tangible

[1] 35 ILCS 120/2.
[2] 35 ILCS 105/3
[3] 35 ILCS 120/1
[4] 35 ILCS 115/3; 86 Ill. Admin. Code § 140.l0l (a).
[5] Ill. Priv. Ltr. Rul. ST 17-0006 -PLR (8/14/ 2017) at p. 11.
[6] *Id.*
[7] 35 ILCS 110/3.
[8] 35 ILCS 120/1; 35 ILCS 1 20/2; 35 ILCS 115/3; 35 ILCS 110/3; 86 Ill. Admin. Code § 140.125(x).

personal property "regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means or other media."[9] 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."[10]
However, 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 [11]

If a transaction does not involve the transfer of any tangible personal property to the customer, then it generally would not be subject to the ROT, UT, SOT or SUT.[12]

Application Service Providers

[9] *Id.*
[10] *Id.;* 86 Ill. Admin. Code § 130.1935(a).
[11] 86 Ill. Admin. Code § 130.1935(a) (l).
[12] Ill. Priv. Ltr. Rul. ST 17-0006-PLR (8/14/2017).

In Illinois, the provision of Software as a Service ("SaaS"), also known as an Application Service Provider ("ASP"), is not taxable: "computer software provided through a cloud-based delivery system - a system in which computer software is never downloaded onto a client's computer and is only accessed remotely - is not subject to tax."[13]

A provider of SaaS is acting as a serviceman and the transaction would not be subject to tax in Illinois where no tangible personal property is transferred to the customer.[14] If a SaaS provider provides to its subscribers an API, applet, desktop agent or a remote access agent to enable the subscriber to access the provider's network and services, the Department has held that the subscriber is receiving computer software.[15]

IV. Discussion

The Company's provision of hardware and software subscriptions as presented are subject to Illinois' Retailers' Occupation Tax. Given the interconnectivity and necessity of both the hardware and the subscription, along with the delivery of portions of firmware via the software subscription, the Company has applied Illinois state sales tax to all hardware and subscription sales and views the sales as bundled hardware and SaaS. The hardware and subscription components of the sale are subject to ROT, rather than Service Occupation Tax, because the tangible personal property is not incidental to the sales of service and is not separated from the offered pricing.

Application Service Providers

The Company understands that Illinois has taken the position that software as a service delivered via a cloud-based system that does not include a transfer of tangible personal property is not a taxable transaction. As described in this offering noted above, for the software subscription to have value, tangible personal property is also obtained by the purchaser. This comes in the form of the noted hardware (cameras, GPS fleet trackers, temperature monitors, and driver ID tokens) as well as the software updates that are continually pushed to that hardware via the software subscription. While portions of the offering are inclusive of cloud-hosted software, the offering does not meet the criteria of exempt SaaS/ASP.

---

[13] See Ill. Gen. Info. Letter No. ST 19-0007-GIL (3/20/2019) at p. 4; Ill. Priv. Ltr. Rul. ST 17-0006-PLR (8/14/2017); Ill. Gen. Info. Letter No. ST 16-0038-GIL (8/18/2016).
[14] See, e.g., Ill. Priv. Ltr. Rul. ST 17-0007-PLR (3/2/2017) at p. 5.
[15] Il. Gen. Info Letter No. ST 19 -0007- GIL (3/20/2019) at p. 4

The hardware is not incidental to the sale, it is an integral component of the Company's service offering, and the software cannot function without the specific Company hardware.

Computer Software
The Company's software is generally not custom to any contract and customers are purchasing a prewritten program that may be updated for all customers simultaneously from time to time.

Additionally, under Illinois law a software license is considered not taxable when the following criteria is met:

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.[16]

The Company's offering is not that of a traditional software license, but as a hybrid software as a service subscription. Components of the offering include firmware embedded on a tangible personal property, which is restricted per our terms of service (Sections 4 &5) in line with 86 Ill. Admin. Code § 130.1935(a)(l)(A)-(D). However, the subscription

[16] 86 Ill. Admin. Code § 130.193S(a) (l).

includes hosted software only available via the Company's web-based platform.

Additionally, the Company's terms of service do not meet 86 Ill. Admin. Code § 130.1935(a)(l)(E). The customer is not required to destroy or return the hardware at the end of the contract.

V. Ruling Request

Based on the foregoing, the Company respectfully requests the that the Department provide a ruling on the accuracy of the conclusion that the Company's presented offering of hardware and software subscriptions is taxable as noted in the Discussion. In the event that the Department determines that the Company's conclusion is not accurate, the Company respectfully requests an opportunity to discuss this matter with the Department before a final letter ruling is issued.

There is no specific trade secret information in either this letter or the attached exhibits that must be redacted prior to public dissemination. The only redactions are those that will be made by the Department pursuant to 2. Ill. Adm. Code 120.ll0(c), including the name and address of the Company, as well as the noted website links and Exhibits that include the Company's name.
Thank you again for your consideration of this matter. If you have any questions, please do not hesitate to call me at (###) ###-####.

DEPARTMENT'S RESPONSE:

Retailers' Occupation Tax and Use Tax

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 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. See 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.

Service Occupation Tax

Retailers' Occupation Tax and Use Tax do not apply to sales of service. Under the Service Occupation Tax Act, businesses providing services (*i.e.*, servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See 86 Ill. Adm. Code 140.101. The transfer of tangible personal property to service customers may result in either Service Occupation Tax liability or Use Tax liability for servicemen, depending upon which tax base they choose to calculate their liability.

Servicemen may calculate their tax base in one of four ways: (1) separately-stated selling price of tangible personal property transferred incident to service; (2) 50% of the serviceman's entire bill; (3) Service Occupation Tax on the serviceman's cost price if the serviceman is a registered de minimis serviceman; or (4) Use Tax on the serviceman's cost price if the serviceman is de minimis and is not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of sales of service. They are required to collect the corresponding Service Use Tax from their customers.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See 86 Ill. Adm. Code 140.101(f). This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit tax to the Department by filing returns and do not pay tax to their suppliers. They provide suppliers with Certificates of Resale for the tangible personal property transferred to service customers.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the

Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of sales of service is less than 35% of the servicemen's annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess, and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See 86 Ill. Adm. Code 140.108.

The Department does not consider the viewing, downloading or electronically transmitting of video, text and other data over the internet to be the transfer of tangible personal property. However, if a company provides services that are accompanied with the transfer of tangible personal property, including computer software, such service transactions are generally subject to tax liability under one of the four methods set forth above.

If a transaction does not involve the transfer of any tangible personal property to the customer, then it generally would not be subject to Retailers' Occupation Tax, Use Tax, Service Occupation Tax, or Service Use Tax.

Computer Software

"'Computer software' means a set of statements, data, or instructions to be used directly or indirectly in a computer in order to bring about a certain result in any form in which those statements, data, or instructions may be embodied, transmitted, or fixed, by any method now known or hereafter developed, regardless of whether the statements, data, or instructions are capable of being perceived by or communicated to humans, and includes prewritten or canned software." 35 ILCS 120/2-25. Generally, sales of "canned" computer software are taxable retail sales in Illinois. Canned computer 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. 86 Ill. Adm. Code 130.1935. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. 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 86 Ill. Adm. Code 130.1935(c)(3). Computer software that is not custom software is considered to be canned computer software.

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.

If a license of canned computer software does not meet all the criteria the software is taxable.

In order to comply with the requirements as set out in Section 130.1935(a)(1), there must be a written "signed" agreement. A license agreement in which the customer electronically accepts the terms by clicking "I agree" does not comply with the requirement of a written agreement signed by the licensor and customer. The Department previously held that an electronic signature did not comply with the requirement of Section 130.1935(a)(1)(A) that the license be evidenced by a written agreement signed by the licensor and the customer. ST 06-0005-PLR (December 16, 2006). In ST 18-0003-PLR (February 8, 2018), the Department decided that an electronic license agreement in which the customer accepts the license by means of a signature in electronic form that is attached to or is part of the license, is verifiable, and can be authenticated will comply with the requirement of a written agreement signed by the licensor and customer. See ST 18-0010-PLR (September 26, 2018) for examples of acceptable written signatures. A license agreement in which the customer electronically accepts the terms by clicking "I agree" remains unacceptable.

Computer software is defined broadly in the Retailers' Occupation Tax Act. However, computer software provided through a cloud-based delivery system – a

system in which computer software is never downloaded onto a client's computer and is only accessed remotely – is not subject to tax. If a provider of a service provides to the subscriber an API, applet, desktop agent, or a remote access agent to enable the subscriber to access the provider's network and services, the subscriber is receiving computer software. Although there may not be a separate charge to the subscriber for the computer software, it is nonetheless subject to tax, unless the transfer qualifies as a non-taxable license of computer software. Illinois generally does not tax subscriptions.

Maintenance Agreements

In general, maintenance agreements that cover computer software 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 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 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 qualify as custom software under Section 130.1935(c) they may not be 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 the charges for training, telephone assistance, installation, consultation, or other maintenance agreement charges, then the whole agreement is taxable as a sale of canned software.

Refunds and Claims

If a taxpayer pays an amount of tax under the Retailers' Occupation Tax Act that is not due, either as a result of a mistake of fact or an error of law, the taxpayer may file a claim for credit with the Department. See 86 Ill. Adm. Code 130.1501. Please note that only persons who have actually paid tax to the Department can file a claim for credit. The retailer will be considered to have satisfied the unconditional repayment requirement where it provides its purchaser with an instrument upon which the purchaser can make a demand upon the retailer/claimant for payment of the tax recovered if the claim is allowed. The retailer's provision of unconditional promissory notes or irrevocable credit memoranda to its purchasers who paid tax in error would satisfy this requirement. No credit shall be given the taxpayer unless the taxpayer shows that he or she has borne the burden of the tax or has unconditionally repaid the amount of the tax to the purchaser from whom it was collected. In other words, if a purchaser has paid tax to his supplier, only that supplier/retailer can file a claim for credit.

Retailers filing such claims must comply with all requirements of 86 Ill. Adm. Code 130.1501. The retailer must first refund tax money paid by the purchaser before proceeding with the claim. Once the retailer has done this, he or she must apply for the credit in the manner described in the regulation. Retailers are not required by law to apply for such credits; rather, this procedure is voluntary.

Analysis

It is the Department’s conclusion that the Company is acting as a serviceman when it provides its cloud-based services. The Company states that “[t]he Company sells the subscriptions in a bundled offering inclusive of the necessary hardware, cables, and accessories.”

The computer software and firmware transferred incident the to the service do not meet the license requirements of Section 130.1935(a)(1), and the Company admits it is not custom to any particular customer. Therefore, the computer software and firmware transferred to the customer incident to the service is tangible personal property and subject to tax. The charges for software and firmware updates transferred incident to the service also are not separately stated and are part of gross receipts and subject to tax.

The Company also provides a warranty or maintenance agreement. Because the charges for the warranty are included in the subscription price, the charges for the warranty are part of the gross receipts and are subject to tax.

The Company is registered with the Department for sales and use taxes. Because the Company does not wish to separately state the selling price of the tangible personal property transferred incident to the service it provides, it must use 50% of the entire bill to its service customers as the tax base, unless the Company is a de minimis serviceman, in which case it may pay Service Occupation Tax based upon the cost price of tangible personal property transferred incident to sales of service. In no event, however, may the tax base be less than the cost price of the tangible personal property transferred. The Company may provide its suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of sales of service. The Company is required to collect the corresponding Service Use Tax from its customers. See 86 Ill. Adm. Code 140.106 and 140.109.

The Company is not required to determine whether it is a de minimis serviceman. The Department's regulations state that "[e]ven though a serviceman meets the de minimis threshold and is otherwise eligible to pay Service Occupation Tax on his cost price, he can nevertheless opt to pay Service Occupation Tax on the selling price of the tangible personal property transferred to service customers as explained in Section 140.106." See 86 Ill. Adm. Code 140.109(b).

The Company is liable for Retailers' Occupation Tax on sales of replacement hardware, cables and accessories that are sold separately as needed at list price. Customers are liable for Use Tax on these sales.

Whether the Company refunds tax paid and files a claim for credit with the Department is a private matter between the Company and its customers. Only the Company can file a claim for credit or refund. The Company's customers cannot file claims for credit or refund directly with the Department based upon tax that was paid by customers to the Company. No mechanism exists under Illinois sales tax laws for customers to make such claims directly with the Department unless the customer remitted the tax directly to the Department.

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.

I hope this information is helpful. 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,

Richard S. Wolters
Chairman, Private Letter Ruling Committee

RSW:rkn