ST-21-0008 01/28/2021 COMPUTER SOFTWARE

This letter discusses computer software. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

January 28, 2021

Dear Xxxx:

This letter is in response to your letter received December 8 2020, 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.

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). Further, the Department's regulations regarding Private Letter Rulings provide that "[i]f there is case law or there are regulations dispositive of the subject of the request, the Department will decline to issue a letter ruling on the subject." 86 Ill. Adm. Code 1200.110(a)(3)(D). The Department recently met and determined that it would decline to issue a Private Letter Ruling in response to your request. We hope, however, the following General Information Letter will be helpful in addressing your questions. In your letter you have stated and made inquiry as follows:

> We are writing on behalf of COMPANY. ("Company") to request a private letter ruling in accordance with 2 Ill. Adm. Code 1200.110. At the time of this request, the Company is not under audit by the Illinois Department of Revenue ("the Department"), nor is there litigation pending between the Company and the Department. To the best of the Company's knowledge, the Department has not previously ruled on a similar issue for the Company, and the Company has never submitted a request for a ruling on a similar issue.
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> The Company's request for ruling relates to whether its licensing of software pursuant to an end user licensing agreement ("EULA") qualifies as a license of computer software under 86 Ill. Adm. Code 130.1935 and as such is not a retail sale of tangible personal property subject to the Illinois Retailers Occupation Tax. Following is a discussion of the facts and our understanding of the law as it pertains to the license agreement and the specific requirements of the regulation.
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> **FACTS:**
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> The Company is the leading provider in Continuous Software Release Management, or "CSRM." The CSRM Platform allows the Company's customers to continuously deliver

software updates across any system. The Company currently offers five different CSRM options delivered to its customers via electronically downloaded software. The five different CSRM options are PLAN1, PLAN2, PLAN3, PLAN4, and PLAN5. Each platform offers different software features, with a maximum of six different software features included in the platform. The six software features are PRODUCT1, PRODUCT2, PRODUCT3, PRODUCT4, PRODUCT5, and PRODUCT6

PLAN1, PLAN2, and PLAN4 are all licensed to a customer using the standard EULA for PRODUCT1 and where applicable the PRODUCT2 terms. PLAN5 is licensed to customers using its own designated EULA. Each EULA consists of clauses typical of most standard EULAs. In addition to acceptance and termination clauses, each EULA contains restrictions on duplication and use, license/transfer, copying the software, and termination. The Company maintains a policy of providing additional license keys to the customer at no charge if the customer's current license fails for any reason, so long as the customer maintains an active subscription with the Company. The EULAs can all be accessed on the Company's website at EMAIL.

When a customer makes a purchase of the CSRM, they either certify that they accept the terms of the EULA by wet or electronic signature, or accept the quote by wet or electronic signature. The electronic signature includes but is not limit [*sic*] to DocuSign. The quote includes a hyperlink to the complete EULA agreement or a reference to the specific pre-negotiated signed EULA. The licensing agreements for the CSRMs can be for fixed periods, or for a perpetual license, depending on the product.

**PRODUCT1 EULA**[1]

The relevant clauses of the PRODUCT1 EULA provide as follows:

BY CLICKING THE "YES" BUTTON BELOW OR BY DOWNLOADING, INSTALLING OR USING THE SOFTWARE, YOU ARE ACCEPTING AND AGREEING TO THE TERMS AND CONDITIONS OF THIS EULA. IF YOU ARE NOT WILLING TO BE BOUND BY THE TERMS AND CONDITIONS OF THIS EULA, THEN CLICK THE "NO" BUTTON BELOW TO TERMINATE SOFTWARE OPERATION OR DO NOT USE OR INSTALL THE SOFTWARE. DO NOT SELECT "I AGREE" OR INSTALL OR USE THE SOFTWARE UNTIL YOU HAVE CAREFULLY READ, UNDERSTOOD, AND AGREED TO THE TERMS AND CONDITIONS OF THIS EULA.

LICENSE GRANT

1. Subject to terms and conditions of this EULA, Licensor hereby grants to You, and You accept, a perpetual, limited, personal revocable, nontransferable, non-sublicensable, nonexclusive license to make internal use of the Software only in binary executable form, for the regular and standard purposes the Software was designed for, only as authorized in this EULA (the "**License**").

[1] *See* PRODUCT1 EULA, attached as Exhibit B.

2. The License allows you to install a single instance of the Software and use the Software on a single specific hardware system at any time per License. You may install, use, access, display and run one copy of the Software at the time. The Software is licensed as a single product. Other than the rights expressly set forth in Section 1 above, no other right or interest whatsoever in or relating to the Software is transferred or granted to You.
3. The Software should be installed in accordance with the instructions of the Licensor. Except as expressly permitted by this EULA, You shall not, nor permit anyone else to, directly or indirectly (i) copy, reverse engineer, decompile, or disassemble the Software or any part of it or otherwise attempt to reconstruct or discover any source code or underlying ideas or algorithms of the Software . . . .

TERM; TERMINATION

4. Upon termination of this EULA by Licensor pursuant to Section 5.2 above, the license granted herein will terminate and You: (i) shall immediately cease to use the Software, (ii) shall pay to COMPANY any amounts owed to COMPANY under this EULA before such expiration or termination; (ii) shall remove the Software from all hard drives, networks and other storage media and destroy all copies of the Software in your possession or under your control. Upon COMPANY request You shall within three (3) days certify destruction of, all full or partial copies of the Software, documentation and related materials provided by COMPANY.

**PRODUCT2 EULA**[2]

The relevant clauses of the PRODUCT2 EULA provide as follows:

BY DOWNLOADING, INSTALLING, OPERATING OR OTHERWISE USING THE SOFTWARE, YOU ARE EXPRESSLY AND EXPLICITLY ACCEPTING THIS AGREEMENT AND AGREEING TO BE BOUND BY ITS TERMS AND CONDITIONS. IF YOU DO NOT AGREE TO THIS AGREEMENT DO NOT MAKE ANY USE OF THE SOFTWARE.

2. **License**. Subject to the terms of this Agreement, the Company hereby grants you, and you accept a limited, non-exclusive, non-sublicensable, non-transferable and fully revocable license to use the Software solely for your internal business purposes, in accordance with the Software's documentation. All other rights in the Software are expressly reserved by the Company.

3. **Prohibited Uses**. Except as specifically permitted herein, without the prior written consent of the Company you agree not to, directly or indirectly: (i) use, modify, incorporate into or with other software, or create a derivative work or any part of the Software; (ii) sell, resell, license (or sub-license), lease, assign, transfer, pledge, or share your rights under this Agreement with or to anyone else; (iii) copy, distribute, publish or reproduce the Software, including without

[2] *See* PRODUCT2 EULA, attached as Exhibit C.

limitation any databases or reports or generated by the Software; (iv) use or permit the Software to be use to perform services for third parties, whether on a service bureau or time sharing basis or otherwise; (v) disclose, publish or otherwise make publicly available the results of any benchmarking of the Software, or use such results for your own competing software development activities; (vi) modify, disassemble, decompile, reverse engineer, revise or enhance the Software or attempt to reconstruct or discover any source code or underlying ideas or algorithms of the Software, except to the extent otherwise permitted under applicable law, in the jurisdiction of use, notwithstanding this prohibition; (vii) access the underlying databases; (viii) ship, transfer or export the Software into any country, or make available or use the Software in any manner which is in violation of applicable export control laws, restrictions or regulations and/or (ix) disclose, provide or otherwise make available trade secrets contained within the Software and related documentation in any form to any third party. You shall implement reasonable security measures to protect such trade secrets (x) remove or otherwise alter any of the Company's trademarks, logos, copyrights, notices or other proprietary notices or indicia, if any, fixed or attached to the Software as delivered to you.

10. **Term; Termination**. This Agreement shall become effective upon downloading, installing, operating or otherwise using the Software. This Agreement will remain in force and effect provided that (i) you have an active applicable PRODUCT1 subscription; and (ii) all Fees (as defined below) were timely paid. Provided, however, that the Company may terminate this Agreement immediately without notice if you do not comply with or otherwise breach any provision of this Agreement. Upon termination of this Agreement: (i) any license granted hereunder shall expire; (ii) you shall discontinue all further use of the Software; and (iii) you shall promptly remove the Software from all hard drives, networks and other storage media under your control. The provisions of this Agreement that, by their nature and content, must survive the termination of this Agreement in order to achieve the fundamental purposes of this Agreement shall so survive upon termination of this Agreement for any reason.

**PLAN5 EULA**[3]

The relevant clauses of the PLAN5 EULA provide as follows:

BY DOWNLOADING, INSTALLING OR USING THE SOFTWARE, YOU ARE ACCEPTING AND AGREEING TO THE TERMS AND CONDITIONS OF THIS AGREEMENT. COMPANY AND YOU MAY BE REFERRED TO IN THIS AGREEMENT, INDIVIDUALLY, AS **"PARTY"** AND, COLLECTIVELY, AS **"PARTIES."**

2. SOFTWARE LICENSE

[3] *See* PLAN5 EULA, attached as Exhibit D.

1. Subject to the terms and conditions of this EULA, we hereby grant you, and you hereby accept, a perpetual, limited, revocable, nontransferable, non-sublicensable, and nonexclusive license to make internal use of the Software only in binary executable form, for the regular and standard purposes the Software was designed for, only as authorized in this EULA.

3. RESTRICTIONS ON USE. Except as expressly permitted by this Agreement, you shall not, or nor permit anyone else to, directly or indirectly:

    1. copy, reverse engineer, decompile, or disassemble the PLAN5 Software or any part of it or otherwise attempt to reconstruct or discover any source code or underlying ideas or algorithms of the PLAN5 Software;

    2. modify, convert, alter, change, manipulate, divide, part or revise the PLAN5 Software, or any part thereof;

    3. assign, sublicense, resell, transfer, distribute, pledge, loan, lease, market, rent, or use the PLAN5 Software in any service bureau arrangement, facility management or third-party training, or otherwise share your rights under this Agreement to any third party;

4. SUBSCRIPTION TERMS; SUBSCRIPTION FEES; MAINTENANCE.

    1. You can commence use of the PLAN5 Software by purchasing a subscription for such number of licenses and for a certain duration of time as shall be set forth in an order form (each a “Subscription” and “Order Form”, respectively). A Subscription entitles you to: (i) use the PLAN5 Software under the terms and conditions set forth herein; and (ii) receive Maintenance (as defined in below) for a certain copy of the PLAN5 Software during the applicable Subscription Term. In this Agreement, “Subscription Term” means the period specified in the Order Form.

    2. Each Subscription expires at the end of the applicable Subscription Term. You shall pay the fees for each Subscription as specified at the time of purchase of such Subscription in an Order Form. The Subscription fee for any additional Subscription will be according to COMPANY’S then-current applicable Subscription fee.

9. TERM; TERMINATION.

    4. Upon termination of this EULA, all Licenses granted herein will terminate and You: (i) shall immediately cease to use the PLAN5 Software, (ii) shall pay to COMPANY any amounts owed to COMPANY under any Order Form; (ii) shall remove the PLAN5 Software from all hard drives, networks and other storage media and destroy all copies of the PLAN5 Software in your possession or under your control, and to the extent requested by COMPANY, provide a certification to that effect within ten (10) business days.

**LAW:**

According to regulation 86 Ill. Admin. Code 130.1935(a)(1), license fees charged in association with software may be exempt from sales and use tax in certain instances. A license of software is not a taxable retail sale if it meets the following five criteria:

1. it is evidenced by a written agreement signed by the licensor and the customer;
2. it restricts the licensee's duplication and use of the software;
3. it prohibits the licensee 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;
4. the licensor has a policy of providing another copy at minimal or no charge if the licensee loses or damages the software, or of permitting the licensee to take 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
5. the licensee must destroy all copies of the software or return them to licensor at the end of the license period. This provision is deemed to be met if the license agreement is a perpetual license.[4]

***ANALYSIS***

The EULAs between the Company and their Customers appears to meet the five prong test established in 86 Ill. Admin. Code 130.1935(a)(1). We seek your confirmation of our understanding.

***The license agreements are evidenced by a written agreement signed by the licensor and the customer.***

To qualify as an exempt software license agreement, it must be evidenced by written document, signed by both parties. The Company has a written agreement in place for each of its platforms and requires acceptance of the written EULAs by electronic signature, including but not limited to DocuSign, or wet signature. The customers either certify that they accept the terms of the EULA by wet or electronic signature or accept the quote by wet or electronic signature. The electronic signature includes but is not limit to DocuSign. The quote includes a hyperlink to the complete EULA agreement or a reference to the specific pre-negotiated signed EULA. This signed acceptance of the written agreement satisfies the first prong of the test.

***The license agreements restrict the licensee's duplication and use of the software***.

[4] 86 Ill. Admin. Code 130.1935(a)(1).

The license agreement must restrict the customer's duplication and use of the software. The Company's EULAs all contain clauses that restrict the customers ability to duplicate and use the software. The EULAs restrict the customers ability to use and duplicate the software in at least two different ways. First all the EULAs restrict the ability of the licensee to copy, reverse engineer, decompile, or disassemble the software. The PRODUCT1, PRODUCT2, and PLAN5 EULAs all state that a licensee is prohibited from attempting to "copy, reverse engineer, decompile, or disassemble" the software, source code, or algorithm.[5] Second the EULAs explicitly prohibit the licensee from making any modifications to the licensor's software. Section 3 of the PRODUCT2 and PLAN3 EULAs explicitly prohibit a licensee's ability to modify the software, and section 1.2 of the PRODUCT1 EULA restricts the licensee's use of the software to "install, use, access, display and run one copy of the Software at a time . . . Other than the rights expressly set forth . . . no other right or interest whatsoever in or relating to the Software is transferred or granted to You."[6] Section 1.2 of the PRODUCT1 EULA further states that if a right was not expressly granted to the Licensee within the EULA, they cannot use the software in that specific manner.[7] Here, the licensee was not explicitly given the right to modify the software, thus their use of the software is restricted by the Company. All three EULAs restrict the licensee's duplication and use of the software, thus the second prong of the test is satisfied.

***The license agreements prohibit the licensee 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.***

The third prong of the test prohibits the licensee 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. The EULAs for PRODUCT1, PRODUCT2, and PLAN5 all contain language that prohibit the licensee 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. Section 1.1 of the PRODUCT1 EULA states, "Subject to terms and conditions of this EULA, Licensor hereby grants to You, and You accept, a . . . nontransferable, non-sublicensable . . . license to make internal use of the Software."[8] Section 1.2 and 1.3 of the PRODUCT2 EULA state, "Subject to the terms and conditions of this Agreement, the Company hereby grants you, and you accept a limited, non-exclusive, non-sublicensable, non-transferable and fully revocable license to use the Software solely for your internal business purposes . . . Except as specifically permitted herein, without the prior written consent of the Company you agree not to, directly or indirectly . . . sell, resell, license (or sub-license), lease, assign, transfer, pledge, or share your rights under this Agreement with or to anyone else."[9] Section 2.1 and 3.3 of the PLAN5 EULA state, "Subject to the terms and conditions of this EULA, we hereby grant you, and you hereby accept, a perpetual, limited, revocable, nontransferable, non-sublicensable . . . license

[5] *See* Exhibit B Section 1.3; Exhibit C Section 1.3; Exhibit D Section 3.1.
[6] *See* Exhibit B Section 1.2; Exhibit C Section 1.3; Exhibit D Section 3.2.
[7] *See* Exhibit B Section 1.2.
[8] *See* Exhibit B Section 1.1.
[9] *See* Exhibit C Section 1.2-1.3.

to make internal use of the Software . . . Except as expressly permitted by this Agreement, you shall not, or nor permit anyone else to, directly or indirectly . . . assign, sublicense, resell, transfer, distribute, pledge, loan, lease, market, rent, or use the PLAN5 Software in any service bureau arrangement, facility management or third-party training, or otherwise share your rights under this Agreement to any third party."[10] All three EULAs prohibit the licensee from licensing, sublicensing, or transferring the software to a third party, thus the third prong of the test is satisfied.

***COMPANY has a policy of providing another copy at minimal or no charge if the licensee loses or damages the software, or of permitting the licensee to take 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 fourth prong of the test requires the licensor to maintain a policy of providing additional copies of the software at minimal or no charge to the licensee if the software becomes lost or damaged. As previously stated above, the Company maintains a policy of providing another software license to the customer at no charge if the customer's current license fails for any reason, so long as the customer maintains an active subscription with the Company. This policy satisfies the fourth prong of the test.

***The license agreements require that the licensee destroy all copies of the software or return them to COMPANY at the end of the license period. This provision is deemed to be met if the license agreement is a perpetual license.***

The last prong of the test requires the licensor to return or destroy any copies of the software at the end of the license period. This prong is deemed satisfied if the license is perpetual. Both the PRODUCT1 and PLAN5 EULA explicitly state that the license being grated to the licensee is perpetual.[11] Furthermore, all three EULAs contain terminations clauses which require the licensee to destroy all copies of the software upon termination of the EULA. Section 5.4 of the PRODUCT1 EULA states, "Upon termination of this Agreement the license granted herein will terminate and . . . you shall promptly remove the Software from all hard drives, networks and other storage media under your control."[12] Section 10 of the PRODUCT2 EULA states, "Upon termination of this Agreement (i) any license granted hereunder shall expire . . . and (iii)you shall promptly remove the Software from all hard drives, networks and other storage media under your control.[13] Section 9.4 of the PLAN5 EULA states, "Upon termination of this EULA, all Licenses granted herein will terminate and You . . . (ii) shall remove the PLAN5 Software from all hard drives, networks and other storage media and destroy all copies of the PLAN5 Software in your possession or under your control, and to the extent requested by COMPANY, provide a certification to that effect within ten (10) business days."[14] For electronic software, removal of the software from the Licensee's

[10] *See* Exhibit D Section 2.1 & 3.3.
[11] *See* Exhibit B Section 1.1. and Exhibit D Section 2.1.
[12] *See* Exhibit B Section 5.4
[13] *See* Exhibit C Section 10.
[14] *See* Exhibit D Section 9.4.

computer or server is tantamount to destruction. Because each of the relevant EULAs requires the Licensee to destroy any copies of the software at the end of the license period, or explicitly states the license is perpetual, the last prong of the test is satisfied.

The provisions of the attached EULAs that are applicable to COMPANY'S downloadable software satisfy all five prongs as outlined above. Accordingly all sales of the five platforms – PLAN1, PLAN2, PLAN3, PLAN4, and PLAN5 -- qualify as exempt licenses of the software and should not be considered retail sales of tangible personal property subject to the Illinois Retailers Occupation Tax. We are unaware of any clarifying authority contrary to our understanding of the law. We respectfully request a ruling from the Department confirming our interpretation.

**DEPARTMENT'S RESPONSE:**

The Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property at retail to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. 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.

"'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 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 canned computer software.

If transactions for the licensing of computer software meet all 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 recognizes that electronic signatures, which are verifiable and can be authenticated, will comply with the requirement of a written agreement signed by the licensor and customer. See ST-18-0003-PLR. Further, the Department has previously found the use of "DocuSign" and other methods of executing agreements by digital signature to meet the requirement for a written signed agreement for purposes of Section 130.1935(a)(1)(A). See ST-18-0010-PLR.

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

Very truly yours,

Alexis K. Overstreet
Associate Counsel

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