

ST 24-0038-GIL 11/22/2024 COMPUTER SOFTWARE

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

November 22, 2024

NAME, TITLE
COMPANY
ADDRESS
EMAIL

Dear NAME:

This letter is in response to your letter dated September 5, 2024, 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 <https://tax.illinois.gov/> to review regulations, letter rulings and other types of information relevant to your inquiry.

Whether 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). A request for a private letter ruling must be made by, or on behalf of, an identified taxpayer. The Department will not issue letter rulings to taxpayer representatives for anonymous or unidentified taxpayers. 2 Ill. Adm. Code 200.110(a)(1). If there is case law or there are regulations dispositive of the subject of the request, the Department will also decline to issue a private letter ruling on the subject. 2 Ill. Adm. Code 200.110(a)(3)(D). There is also certain information that must be included in each request for a private letter ruling as provided in 2 Ill. Adm. Code 200.110(b)(1)-(8). The Department determined not to issue a Private Letter Ruling in response to your request because there are regulations dispositive of the subject of the request. However, the Department is issuing a General Information Letter to help address your question. In your letter you have stated and made inquiry as follows:

I am writing to request a formal ruling regarding the applicability of Illinois sales tax to computer software licenses and maintenance agreement regarding Title Section 130.1935 of the Illinois Administrative Code. Specifically, I would like to obtain guidance as to if the sales of our software licenses are nontaxable retail sales based on the five criteria listed in 130.1935.

Issue: COMPANY registered for a sales tax account and began collecting Illinois sales tax beginning with the DATE filing period. We have been collecting sales tax and remitting monthly as per Illinois Department of Revenue requirements. It recently came to our attention that, based on COMPANY'S Order Agreements, these sales meet the criteria to be considered a non-taxable retail sale.

Background: I am seeking clarification on whether this product/service is taxable or if any exemptions apply. COMPANY is a provider of software for defined benefit pension plans, other post-employment benefit (OPED) plans, foundations, and endowments. COMPANY products are locally installed licensed software. COMPANY'S PRODUCT can be installed on any system that meeting [sic] the minimum supported requirements. PRODUCT is not a cloud-based solution.

During an economic nexus review, it was determined that COMPANY had exceeded Illinois' \$100,000 sales threshold. We registered with the Department of Revenue and began collecting sales tax as of the DATE period.

Relevant Facts: Per Section 130.1935 a) "Computer Software means all types of software including operational, applications, utilities, compliers, templates, shells, and other forms. Canned 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. The sales at retail, or transfer, of canned software intended for general or repeated use its [sic] taxable, including the transfer by a retailer of software which is subject to manufacturer licenses restricting the use of reproduction of the software.

- 1) 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;
 - i) An electronic agreement in which the customer accepts the license by means of an electronic signature that is

verifiable and can be authenticated and is attached to or made part of the license will comply with this requirement.

- ii) A license agreement in which the customer electronically accepts the terms by clicking "I agree" does not comply with this requirement.
- 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.

I have enclosed a copy of a PRODUCT Order Form which includes detailed terms and conditions.

Specific Questions:

1. **Based on the Order Agreement Terms and Conditions enclosed, are the sales of PRODUCT software licenses considered to be a nontaxable retail sale in Illinois?**
2. **If it is determined that sales of PRODUCT software licenses are not a taxable retail transaction in Illinois, are we able to issue refunds to customers, amend returns, and request refunds for taxes collected in error.**

We are seeking your guidance to ensure compliance with Illinois sales tax regulations and to make informed business decisions. We appreciate your assistance and look forward to your response.

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.

"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. Computer software includes all types of software including operational, applicational, utilities, compilers, templates, shells and all other forms. 86 Ill. Adm. Code 130.1935(a).

Generally, sales or transfers of "canned" computer software intended for general or repeated use are taxable retail sales in Illinois. Canned 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. The sale or transfer by a retailer of computer software which is subject to manufacturer licenses restricting the use or reproduction of the software is also taxable. 86 Ill. Adm. Code 130.1935(a). However, if all of the criteria provided in subsection (a)(1) of Section 130.1935 are met, then neither the sale or transfer of the software nor the subsequent software updates are subject to Retailers' Occupation Tax. Specifically, 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.

86 Ill. Adm. Code 130.1935(a)(1). If a license of canned computer software does not meet all the criteria, the software is taxable.

Please note that it is very common for software to be licensed over the internet and the customer to accept the license terms by checking a box or clicking "I agree". 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. 86 Ill. Adm. Code 130.1935(a)(1)(A)(ii). To meet the signature requirement for an exempt software license, the agreement must contain the written signature of the licensor and customer. An electronic agreement in which the customer accepts the license by means of an electronic signature that is verifiable and can be authenticated and is attached to or made part of the license will comply with this requirement. 86 Ill. Adm. Code 130.1935(a)(1)(A)(i).

Computer software is defined broadly in the Retailers' Occupation Tax Act. However, computer software provided through a cloud-based delivery system is not subject to tax. A cloud-based delivery system is one in which computer software is never downloaded onto a client's computer and only accessed remotely. 86 Ill. Adm. Code 130.1935(a)(3). 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. 86 Ill. Adm. Code 130.1935(a)(4). 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.

It appears that the Order Form and Terms and Conditions provided do not require the customer to destroy or return all copies of the software to the licensor at the end of the license period. If this is the case, the requirements of Section 130.1935 are not met, and the sales of the computer software are taxable.

I hope this information is helpful. If you require additional information, please visit our website at <https://tax.illinois.gov/> or contact the Department's Taxpayer Information Division at 800-732-8866.

Very truly yours,

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Richard S. Wolters
Associate Counsel

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