

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. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

June 2, 2009

Dear Xxxxx:

This letter is in response to your letter received in this office on February 4, 2009 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 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:

On behalf of COMPANY we hereby respectfully request a Private Letter Ruling from the Illinois Department of Revenue ("IDOR") regarding the classification one of the company's transactions as either taxable sales or nontaxable licensing of software for purposes of the Retailers' Occupation Tax and the Use Tax under 86 Illinois Administrative Code Section 130.1935.

COMPANY is a software development company. Recently, it has entered into a contract with an Illinois based corporate purchaser (please see the attached software license agreement, which the taxpayer requests remain confidential in its entirety) for the licensing of its "canned" software. The specific issue that has been raised by the parties to this agreement is what the proper interpretation of 86 Ill. Adm. Code 130.1935(a)(1)(E). This section states:

...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.

COMPANY's interpretation of the provision is that if the contract is perpetual, it does not have to contain a provision requiring the destruction and return of all software copies and the licensee is **not** required to return or destroy copies of the contract upon any upon [sic] termination of the agreement (e.g., resulting from breach of contract). COMPANY notes that the attached license agreement contains a provision requiring the destruction or return of the software upon any termination (Exhibit C, License Agreement). Please note that COMPANY's reasoning for this position is that if a license agreement is perpetual, there is no reason for the destruction or return of the software, as the agreement is not anticipated to terminate.

The taxpayer's question is whether this provision is actually required in the case of a perpetual license and, if it is, whether any documentation of the return or destruction of the software is required. For purposes of issuing the ruling requested below, please note that the following portions of the attached agreement, which should be considered an integral part of this Private Letter Ruling request, relate to 86 Ill. Adm Code 130.1935 in the following manner(s):

- 1) The contract between COMPANY and its Illinois customer is evidenced by a written agreement and signed by COMPANY and the customer, as required by 86 Ill. Adm. Code 130.1935(a)(1)(A) (pg. 13 of the agreement, pg. 3 of Exhibit A, Sample Schedule A-(1), and pg. 3 of Exhibit A, Sample Schedule A-(2)). (Please refer to the highlighted portions).
- 2) The contract restricts the customer's duplication and use of the software, as required by 86 Ill. Adm. Code 130.1935(a)(1)(B) (Section 1.2 of the contract and Exhibit C). (Please refer to the highlighted portions).
- 3) The contract prohibits the customer from licensing, sublicensing, or transferring the software to a third party without the permission and continued control of the licensor as required by 86 Ill. Adm. Code 130.1935(a)(1)(C). (Section 6.2 of the contract and Exhibit C). (Please refer to the highlighted portions).
- 4) The contract permits the licensee to make and keep archival copies of the software as stated in the contract and as required by 86 Ill Adm. Code 130.1935(a)(1)(D) (Section 1.2 of the contract and Exhibit C). (Please refer to the highlighted portions).
- 5) The license granted between the parties is perpetual as referred to in 86 Ill. Adm. Code 130.1935(a)(1)(E) (Section 1.2 of the contract and Exhibit C). (Please refer to the highlighted portions).

COMPANY respectfully requests that the IDOR issue a ruling that: 1) 86 Ill. Adm. Code 130.1935(a)(1)(E) is deemed to be met in cases of perpetual license agreements without any required or actual return or destruction of the software or documentation that such software was actually returned or destroyed and that, 2) the attached contract for license of software will not be taxable for purposes of the Illinois Retailers' Occupation Tax or Use Tax.

For purposes of this request for a private letter ruling, please note that the Illinois Business Tax number of the taxpayer is #.

COMPANY is:

- 1) Requesting this ruling solely in regards to its licensing of software to a licensee located in Illinois.
- 2) Not currently under audit or investigation by the IDOR, or any agency of Illinois with respect to this issue and has not received a notice of adjustment, a notice of deficiency, or an assessment with respect to this issue. (It is anticipated that the first billing for this transaction will occur in January of 2009 or shortly thereafter.)
- 3) Not aware of any other sources of authority on this specific issue, either in agreement or contrary to the company's interpretation of the regulation. If such authority exists, the company is unable to locate such authority. (Neither the taxpayer or its representatives have previously submitted this or any similar issue to the IDOR for a letter ruling).
- 4) Not presently pursuing any protest, litigation or negotiation on this issue with the IDOR.

The company understands that any factual information or assumptions stated in this letter are subject to the review of the IDOR.

Requests for additional information from the taxpayer as deemed necessary by the Director of Revenue to issue the desired ruling should be made to me. A power of attorney authorizing me to represent COMPANY with regard to this matter at hand is enclosed.

Please note that the taxpayer respectfully requests a conversation and/or conference with the IDOR if it is unable to issue the ruling desired.

The taxpayer also requests that any specific information (names, addresses, tax identification numbers, etc.) relating either to the taxpayer or its **customer** be deleted prior to any public dissemination of a private letter ruling generated by this request. The taxpayer also requests that any specific trade information, including the attached contract in its entirety, likewise be deleted prior to any public dissemination.

If you need to contact me, you may do so by either calling or contacting me, either by mail to the address listed below, or by e-mail to the e-mail address listed below.

Your prompt reply to this matter is appreciated.

DEPARTMENT'S RESPONSE:

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 to 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 has determined that it will no longer issue Private Letter Rulings regarding whether a specific license of prewritten (canned) computer software meets the requirements of subsection (a)(1) of 86 Ill. Adm. Code 130.1935. It is the Department's position that its regulation at

86 Ill. Adm. Code 130.1935 is dispositive of the subject of your request, as are several PLRs and GILs that the Department has issued which can be found on the Department's website.

Generally, retail sales or transfers of "canned" computer software are taxable in Illinois regardless of the means of delivery. For instance, the sale or transfer of canned computer software downloaded electronically would be taxable. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See 86 Ill. Adm. Code 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. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreements would be taxable as sales of canned 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.

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.

You have inquired as to the interpretation of 86 Ill. Adm. Code 130.1935(a)(1)(E) regarding perpetual licenses of computer software. Subsection (a)(1)(E) of 86 Ill. Adm. Code 130.1935 provides that, if the software license agreement is for a perpetual term, the provisions requiring that the customer must destroy or return all copies of the software to the licensor at the end of the license

period are not required to be set forth in the license agreement. If a perpetual software license agreement contains a provision that requires the destruction or return of the software upon a termination of the agreement, that provision will meet the requirements of subsection (a)(1)(E) of 86 Ill. Adm. Code 130.1935.

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,

Terry D. Charlton
Senior Counsel, Sales & Excise Taxes

TDC:msk