

**Illinois Department of Revenue
Regulations**

Title 86 Part 130 Section 130.1935 Computer Software

**TITLE 86: REVENUE
PART 130
RETAILERS' OCCUPATION TAX**

Section 130.1935 Computer Software

- a) Computer software means all types of software including operational, applicational, utilities, compilers, templates, shells and all 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 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.
- 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;
 - 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.

EXAMPLE: A retailer of computer software and related products sells or transfers a shrink-wrapped software program to a customer. A "license agreement" contained on or in the package, which by its terms becomes effective upon opening of the package, states that the customer does not receive title to the program and that the customer may not copy the program except to make a backup or archival copy while he owns the program. The license agreement is not evidenced by a written agreement signed by the customer.

The license does not prohibit the customer from selling the program to a third party. If the customer loses or damages the program, the vendor will not replace it free or for a minimal charge. Since it fails to meet all the requirements for treatment as an exempt license, the transfer from the vendor to the customer is a taxable retail sale of software.

- 2) Value-added resellers who acquire software for relicensing or transfer to consumers after modification or adaptation of the software may acquire the software as a sale for resale by presenting their suppliers with valid certificates (see Section 130.1410 of this Part).
- b) Tax applies to the entire charge made to the customer, including charges for all associated documentation and materials. Charges for updates of canned software are considered to be sales of software. Charges for training, telephone assistance, installation and consultation are exempt if they are separately stated from the selling price of canned software. Maintenance agreements for software will be treated in the same manner as other maintenance agreements. Sellers of maintenance agreements must pay tax on their cost price of the materials transferred incident to the completion of a maintenance agreement.
- c) Custom Computer Programs
- 1) Custom computer programs prepared to the special order of the customer are not subject to tax under the Retailers' Occupation Tax, Use Tax, Service Occupation Tax or Service Use Tax. To be considered exempt software, the following elements must be present:
 - A) Preparation or selection of the program for the customer's use requires an analysis of the customer's requirements by the vendor; and
 - B) The program requires adaptation by the vendor to be used in a specific work environment, e.g., a particular make and model of a computer using a specified input or output device.
 - 2) Custom computer programs do not include "canned" or prewritten computer programs held for general or repeated sale or lease. Modification of an existing prewritten program to meet the customer's needs is custom software. If modified software is held for general or repeated sale or lease, it is canned software. Custom software means the software which results from real and substantial changes to the operational coding of canned or pre-written software in order to meet the specific individualized requirements of the purchaser for his limited or particular use.

EXAMPLE: Canned software is purchased with a resale certificate by a programmer who modifies it to meet a customer's specific needs. The transfer to the customer is exempt from tax. If that program, as modified, is sold to other customers without further modification, it is taxable canned software, as are copies or repeat orders of such modified software.

3) The selection of pre-written or canned programs or program modules assembled by the vendor into a software package does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. If the pre-written program or module was previously marketed, the new program will qualify as a custom program if the price of the pre-written program was 50% or less of the price of the new program. If the pre-written program was not previously marketed, the new program will qualify as a custom program if the charge made to the customer for custom programming services, as evidenced by the records of the seller, was more than 50% of the contract price to the consumer.

- d) All software used to operate exempt manufacturing machinery and equipment (see 86 Ill. Adm. Code 130.330) is exempt.

(Source: Amended at 24 Ill. Reg. 15104, effective October 2, 2000)