

A provider of software as a service is acting as a serviceman. If the provider does not the transfer any tangible personal property to the customer, then the transaction generally would not be subject to Retailers' Occupation Tax, Use Tax, Service Occupation Tax, or Service Use Tax. If the provider transfers to the customer an API, applet, desktop agent, or a remote access agent to enable the customer to access the provider's network and services, it appears the subscriber is receiving computer software that is subject to tax. See 86 Ill. Adm. Code Parts 130 and 140. (This is a GIL.)

August 18, 2016

RE: COMPANY

Dear Xxxxx:

This letter is in response to your letter dated October 1, 2015, and emails dated February 9, 2016 and April 19, 2016, 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](http://www.tax.illinois.gov) to review regulations, letter rulings and other types of information relevant to your inquiry.

In your letter you have stated and made inquiry as follows:

Our client, COMPANY, ("COMPANY") and its wholly owned subsidiary ABC ("ABC"), respectfully requests a private letter ruling pursuant to Ill. Admin. Code 1200.110, regarding the application of the Illinois Retailers' Occupation Tax to revenue received by ABC, a company it recently acquired.<sup>1</sup> ABC provides biomedical information and analysis solutions for the exploration, interpretation and analysis of complex biological systems.

We note at the outset that ABC is not currently registered for Illinois Retailers' Occupation Tax purposes. After acquiring ABC in 2013, COMPANY began to investigate whether ABC had established nexus in Illinois and whether its revenue was subject to the Illinois Retailers' Occupation Tax. The investigation subsequently prompted this private letter ruling request, as well as an application for voluntary disclosure. ABC has filed an Application for Voluntary Disclosure (BOA-2). to voluntary [sic] disclose any tax liability should the Illinois Department of Revenue ("Department") deem that its services are subject to the Retailers' Occupation Tax. See Application for Voluntary Disclosure (BOA-2), attached hereto as **Exhibit A**.

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<sup>1</sup> Prior to its acquisition, ABC was known as XYZ.

We note that ABC has not been contacted by the Department with regard to its state tax obligations, nor is it involved in any protest or litigation with the Department over the subject matter of this letter ruling request.

To facilitate your review of the information necessary to respond to the requested ruling, we have presented the request in the following manner:

- I. Facts
- II. Issues
- III. Pertinent Authority
- IV. Analysis
- V. Ruling Requested

## **I. Facts**

In 20XX, ABC was acquired through a stock acquisition by COMPANY.<sup>2</sup> ABC is a bioinformatics company specializing in providing biomedical information and analysis solutions for the exploration, interpretation and analysis of complex biological systems. ABC's activities in Illinois were limited to the solicitation of sales. ABC does not have any offices or resident employees in the state. In addition, ABC maintains its computer servers outside the State of Illinois. ABC is a c-corporation with a calendar year end. ABC was incorporated in STATE 1 in 19XX; and is headquartered in STATE 2.

ABC offers the following services to its customers under a "Software as a Service" ("SaaS") model, which includes PRODUCT 1, PRODUCT 2, and PRODUCT 3.

### **PRODUCT 1**

ABC's PRODUCT 1 or "ABC PRODUCT 4" allows customers to model, analyze and understand complex biological and chemical systems in their experimental data by identifying relationships, mechanisms, functions and pathways of relevance. PRODUCT 1 is provided to customers via a SaaS model and provides the PRODUCT 1 service for a paid upfront fee covering a set and determined period of time (usually 1 year).<sup>3</sup> See ABC PRODUCT 1 Sample Invoice, attached hereto as **Exhibit B**. The PRODUCT 1 Cloud Offering User Agreement ("PRODUCT 1 User Agreement") grants the customer "a limited, nonexclusive, nontransferable license to access" ABC's online, web-based applications in connection with the SERVICE 1 product. See PRODUCT 1 User Agreement, ¶ 2.a., attached hereto as **Exhibit C**. It is important to note that although the Agreement may reference the term "license" or "license fee," ABC does not in fact license or lease any software or tangible personal property to the customer under the Agreement. The PRODUCT 1 User Agreement does not provide customers the right to take possession, use, or control or direct the use of ABC's proprietary

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<sup>2</sup> COMPANY is a c-corporation with a calendar year end. COMPANY was incorporated in STATE 2 in 19XX; and is headquartered in STATE 3. COMPANY is registered and in good standing with the State of Illinois for state tax purposes.

<sup>3</sup> PRODUCT 1 also sold under the "Pay per Use" ("PPU") model whereby a customer pays an upfront license fee allowing access to the PRODUCT 1 system, without the ability to upload datasets (as is standard in the regular PRODUCT 1 license). In addition, the customer agrees to pay a set and determined fixed fee for any dataset uploads it initiates.

software which is used to provide the PRODUCT 1 service. See *Id.* The PRODUCT 1 User Agreement grants the customer the following rights:

- (i) To upload PRODUCT 1<sup>4</sup> into the Cloud Offering<sup>5</sup> and run analyses on PRODUCT 1 on behalf of and for the benefit of the Customer;
- (ii) To use, review and analyze Content<sup>6</sup> and Results<sup>7</sup> in accordance with Documentation<sup>8</sup> supplied by ABC, solely for Customer's internal research and internal business purposes;
- (iii) To share Results with other users of Cloud Offering as permitted by standard functionality enabled by Cloud Offering and Documentation...
- (iv) To export as permitted by standard functionality enabled by Cloud Offering, and publish or disclose Results outside of the Cloud Offering in accordance with Documentation[.]

PRODUCT 1 User Agreement, ¶ 2.a., **Exhibit C**.

Typically, the PRODUCT 1 User Agreement is accessed by customers online and requires the customer to check a box that states he or she accepts the terms of the subscription agreement.

In addition, if requested, an Application Program Interface ("API") may be electronically provided to the customer to access PRODUCT 1. Essentially, the API allows customers to automatically send data directly from their software platform to PRODUCT 1 for analysis. ABC does not charge its customers for this API. An Export API is also available to commercial customers for a fee, which enables customers to programmatically export their analysis results from PRODUCT 1 into another format, such as a data file which the customer can then use for further processing. In either case, the API is incidental to the PRODUCT 1 service provided to the customer.

**PRODUCT 2**

ABC's PRODUCT 2 allows customers to identify and prioritize causal variants in its data by drilling down to a small, targeted subset of variants based both upon published

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<sup>4</sup> "PRODUCT 6" means "all data (including data sets or data files) that Customer or Customer's Representative uploads to the Cloud Offering or causes or requests that ABC upload into the Cloud Offering during the term of this Agreement. PRODUCT 1 Cloud Offering User Agreement, at ¶ 1, **Exhibit C**.

<sup>5</sup> "Cloud Offering" means "ABC online, web-based application(s) relevant to ABC's PRODUCT 5 which are made accessible to Customer by ABC via a user account accessing one or more designated websites and all associated Documentation provided or accessible in connection with such offering, and any updates or upgrades of the same which are made available to Customer hereunder..."*Id.*

<sup>6</sup> "Content" means "any information or content made available by ABC in connection with Customer's access to or use of the Cloud Offering[.]" *Id.*

<sup>7</sup> "Results" means "the analysis results generated by the Cloud Offering based on the Customer Biological Data[.]" *Id.*

<sup>8</sup> "Documentation" means "written, audio, visual, and/or other user materials related to the Cloud Offering provided to Customer[.]" *Id.*

biological evidence and its own knowledge of disease biology. PRODUCT 2 allows customers to consider variants from multiple biological perspectives, explore different biological hypotheses, and identify the most promising variants to follow up. PRODUCT 2 is a unique reporting product, which is based on a one time sample upload. The reports associated with the samples are available online via a hosting model. PRODUCT 2 is provided to customers via a SaaS model and allows customers to access the service for a paid upfront fee covering a set and determined period of time (usually 1 year). See ABC PRODUCT 2 Sample Invoice, attached hereto as **Exhibit D**. The ABC<sup>9</sup> PRODUCT 2 Cloud Offering User Agreement ("VA User Agreement") does not provide customers the right to take possession, use, or control or direct the use of ABC's proprietary software, which is used to provide the PRODUCT 2 service. See PRODUCT 2 User Agreement, ¶ 2.a, attached hereto as **Exhibit E**. It is important to note that although the Agreement may reference the term "license" or "license fee," ABC does not in fact license or lease any software or tangible personal property to the customer under the contract. The ABC PRODUCT 2 User Agreement grants the customer a "limited, nonexclusive, nontransferable license:"

- (i) To access and use Cloud Offering<sup>10</sup> in accordance with Documentation<sup>11</sup> supplied by ABC, solely for Customer's internal research and internal business purposes;
- (ii) To upload PRODUCT 5<sup>12</sup> and other PRODUCT 6<sup>13</sup> on behalf of and for the benefit of Customer into the Cloud Offering;
- (iii) To analyze Active Customer Variant Samples and Active Third Party Variant Samples in order to generate Results solely on behalf of and for the benefit of Customer for Customer's internal research and internal business purposes;
- (iv) Share through the Cloud Offering in accordance with Documentation with other users of the Cloud Offering (a) Results, (b) Customer Variant Samples and (c) Third Party Variant Samples which have been shared with Customer through the Cloud offering[.]

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<sup>9</sup> After its acquisition, COMPANY 1 was renamed ABC ("ABC").

<sup>10</sup> "Cloud Offering" means "the ABC online, web-based application(s) relevant to ABC PRODUCT 2 which are made accessible to Customer by ABC via a user account accessing one or more designated websites and all associated Documentation provided or accessible in connection with such offering, and any updates or upgrades of the same which are made available to Customer hereunder...." PRODUCT 2 User Agreement, at p.2, attached hereto as **Exhibit D**.

<sup>11</sup> "Documentation" means "written, audio, visual, and/or other user materials related to the Cloud Offering provided to Customer[.] *Id.*"

<sup>12</sup> "PRODUCT 5" means "a single immutable set of called variants relative to human reference genome sequence from one physical sample (e.g., a biopsy). *Id.*"

<sup>13</sup> "PRODUCT 6" means "all data that Customer or Customer Representative uploads to the Cloud Offering or causes or requests that ABC upload into the Cloud Offering during the term of this Agreement, including without limitation any Customer Variant Samples, gene lists custom variant lists or other data. *Id.*"

- (v) To export, publish or disclose Results outside of the cloud Offering in accordance with Documentation[.]

PRODUCT 2 User Agreement, ¶ 2.a, **Exhibit D**.

Typically, the PRODUCT 2 User Agreement is accessed by customers online and requires the customer to check a box that states he or she accepts the terms of the subscription agreement.

**PRODUCT 3**<sup>14</sup>

ABCs PRODUCT 3 is an interactive web-based report used primarily for gene expression experiments, providing a fast and accurate biological and statistical analysis of the customer's experimental data. PRODUCT 3 is a unique reporting product, which is based on a one time sample upload. The reports associated with the samples are available online via a hosting model.

The PRODUCT 3 service is provided to customers via a SaaS model and made accessible to the customer via a user account accessing one or more designated websites. The customers are charged a fee per project report. See PRODUCT 3 Sample Invoice, attached here to as **Exhibit F**. The PRODUCT 3 Cloud Offering User Agreement ("PRODUCT 3 User Agreement") does not provide customers the right to take possession, use, or control of [sic] direct the use of ABC's proprietary software that is used to provide the PRODUCT 3 service. See PRODUCT 3 User Agreement, ¶ 2.a, attached hereto as **Exhibit G**. It is important to note that although the Agreement may reference the term "license" or "license fee," ABC does not in fact license or lease any software or tangible personal property to the customer under the contract. The PRODUCT 3 User Agreement grants the customer a "limited, nonexclusive, nontransferable license:"

- (A) to access, view and analyze PRODUCT 3<sup>15</sup> available to Customer in compliance with the Documentation, solely for Customer's internal research and internal business purposes;
- (B) to share PRODUCT 3 through the PRODUCT 5<sup>16</sup> with other users of the PRODUCT 5, subject to the restrictions identified in section 3 (Customer Restrictions, Obligations, and Limitations), and further provided that such sharing is solely for research and educational purposes and specifically not associated with any financial gain or other consideration and further provided that any sharing restrictions identified in the relevant Ordering Document and Documentation are complied with; and

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<sup>14</sup> Sales of the PRODUCT 3 product will be discontinued as of December XX, 20XX.

<sup>15</sup> "PRODUCT 3" means the report generated by the PRODUCT 4 that may be accessed through the PRODUCT 5 and which is based on a specific Biological List (i.e., generated using customer biological data or input). PRODUCT 3 User Agreement, at p.3, attached hereto as **Exhibit G**.

<sup>16</sup> "PRODUCT 5" means the ABC online web-based application which allows Customer to access an PRODUCT 3 and which is made accessible by ABC via one or more designated websites provided by ABC." *Id.*

(C) to export, publish or disclose Active Customer PRODUCT 3 and Active Third Party PRODUCT 3 outside of the Cloud Offering in accordance with Documentation, subject to the restrictions identified in section 3 (Customer Restrictions, Obligations, and Limitations) below.

See PRODUCT 3 User Agreement, ¶ 2, **Exhibit G**.

Typically, the PRODUCT 3 User Agreement is accessed by customers online and requires the customer to check a box that states he or she accepts the terms of the subscription agreement.

## **II. Issues**

- A. Whether ABC's biomedical information and analysis solutions, including ABC'S PRODUCT 6, PRODUCT 7, PRODUCT 3 constitute non-taxable services?
- B. Assuming *arguendo*, that ABC's PRODUCT 6, PRODUCT 7, and PRODUCT 3 are deemed to constitute computer software, whether such software licenses constitute a non-taxable retail sale pursuant to Ill. Admin. Code 130.1935(a)(1)?
- C. Assuming *arguendo*, that ABC's PRODUCT 6, PRODUCT 7, and PRODUCT 3 are subject to the Retailers' Occupation Tax, whether the sale of such services should be sourced to Illinois?

## **III. Pertinent Authority**

### **Generally**

In Illinois, the tax commonly referred to as a "sale and use tax," is actually four distinct occupation and privilege taxes that are imposed on the sale and use of tangible personal property in Illinois. The Retailers' Occupation Tax (ROT) is imposed on all persons engaged in the business of selling tangible personal property at retail in the state. 35 ILCS 120/2. 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. 35 ILCS 105/3. "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." 35 ILCS 120/1.

The Service Occupation Tax (SOT) is imposed on tangible personal property transferred by a serviceperson as an incident to the provision of a service. 35 ILCS 115/3. 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. 35 ILCS 110/3.

### **Information or Data**

Information or data that is electronically transferred or downloaded is not considered the transfer of tangible personal property in Illinois. See 86 Ill. Admin. Code 130.2105(a)(3); see also Gen. Info. Letter No. ST 11-0052 (6/30/2011) ("If a company provides access to a database of information and does not transfer any software or other tangible personal property to its customers, the company would not incur Illinois Retailers' Occupation Tax, Use Tax, Service Occupation Tax, or Service Use Tax liability.")

## **Computer Software**

In Illinois, computer software (other than custom software programs) is statutorily defined as tangible personal property and its sale or use is taxable. See 35 ILCS 120/2; 35 ILCS 120/2; 35 ILCS 115/3; 35 ILCS 110/3; Ill. Admin. Code 86 § 140.125(x). "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. Ill. Admin. Code 86 § 140.125(x). 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." *Id.*; Ill. Admin. Code 130.1935(a).

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.

Ill Admin. Code 130.1935(a)(1).

The Department has stated that software licensed over the Internet requiring the customer to check a box that states he or she accepts the license terms, does not constitute a written agreement signed by the licensor and the customer for purposes of Ill. Admin. Code 130.1935(a)(1)(A). To meet the signature requirement for an exempt

software license, the agreement must contain the written signature of the licensor and customer. See Ill. Gen. Info. Letter No. ST 12-0011-GIL (2/29/2012).

It is important to note that Department has stated that "if one is not transferring any canned (prewritten) computer software and no tangible personal property of any kind is being transferred, then no Retailers' Occupation Tax or Use Tax would be incurred on the transaction." Ill. Gen. Info. Letter No. ST 10-0062-GIL (8/4/2010).

### **Application Service Providers**

The Department has declined to issue letter rulings addressing the taxability of computer software Application Service providers, software hosting, and web-based software and has stated that:

The Department believes that the proper forum for providing guidance regarding transactions involving computer software Application Service Providers (ASP's), software hosting, and web-based software is through a formal administrative rulemaking process rather than through individual inquires such as letter ruling requests. The Department at present is in the process of researching the nature and type of services and products provided by these types of providers, including discussions with industry participants. *The Department has found, based on the discussions to date and previous letters received by the Department that the manner in which these services or products are provided can vary greatly.*

When the Department has completed its review of these products or services, it intends to propose regulations for adoption. Until that time, these types of providers will have to determine, based on the definition contained in Section 2-25 of the Retailers' Occupation Tax Act (35 ILCS 120/2-25), whether the products they sell or lease are "computer software."

Ill. General Information Letter ST 13-0049 GIL (09/11/2013).

Although the Department has previously declined to rule on the taxability of service transactions involving computer software ASPs, because the "manner in which these products and services can vary greatly," we believe that the detailed facts (e.g., detailed descriptions, invoices, and agreements) submitted herein will provide the Department with sufficient information and detail to rule on the application of tax to our particular fact situation and provide our client with much needed guidance.

In addition, we note that the Department's lack of guidance on this issue renders sellers vulnerable to class action lawsuits in the event the sellers collect sales tax without clear statutory authority. The Department's failure to provide guidance on this important tax question unfairly jeopardizes taxpayers and creates an uncertain business environment.

### **IV. Analysis**

**A. ABC's PRODUCT 6, Variant Analysis, and PRODUCT 3 constitute non-taxable services and are not subject to the Retailers' Occupation Tax.**

ABC's PRODUCT 6, PRODUCT 7, and PRODUCT 3 constitute non-taxable services, and therefore, are not subject to the Retailers' Occupation Tax ("ROT"). In Illinois, the ROT is imposed on all persons engaged in the business of selling tangible personal property at retail in the state. 35 ILCS 120/2. However, the ROT is not imposed on the sale of services. We note that some states have taken the position that certain services constitute the sale of computer software. However, we do not believe such a position is statutorily supported by Illinois' tax scheme.

In Illinois, computer software (other than custom software programs) is statutorily defined as tangible personal property and its sale or use is taxable. See 35 ILCS 120/2. However, Illinois Administrative Code Section 130.1935(a)(1) specifically provides that 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 case of a perpetual license, without being set forth in the license agreement.

Ill. Admin. Code 130.1935(a)(1).

Nevertheless, ABC submits that it is not engaged in the business of licensing computer software, but rather provides a non-taxable service which allows customers the ability to model, analyze and understand complex biological and chemical systems in their experimental data, identify key relationships and causal variants, and conduct biological and statistical analysis of their experimental data.

ABC's services are provided via a SaaS model, which allows the customer to access ABC's proprietary software via the Internet. The proprietary software which allows ABC to provide its services is located on servers which are owned or leased by ABC and located outside the State of Illinois. ABC's customers cannot install, download, or transfer the application software to their own computers. ABC's customers do not exercise any control, custody or possession over the software or the hardware on which the software is hosted. Customers generally do not receive any tangible personal

property in connection with the services provided by ABC.<sup>17</sup> Therefore, ABC respectfully submits that its' PRODUCT 6, PRODUCT 7, and PRODUCT 3 products constitute non-taxable services and are not subject to the Retailers' Occupation Tax.

It is clear that Illinois' ROT scheme does not support the application of tax to services which are provided via a SaaS model. The ROT is imposed on all persons engaged in the business of selling tangible personal property at retail in the state. 35 ILCS 120/2. "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." Ill. Admin. Code 86 § 140.125(x). "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." 35 ILCS 120/1 (emphasis added). Although Illinois statutes and regulations do not specifically define the term "transfer" for the purposes of the ROT, Black's Law Dictionary defines "transfer" as "to convey or move from one place or one person to another; to pass or hand over from one to another, esp. to change over the possession or control of." Black's Law Dictionary 1636 (9<sup>th</sup> ed. 2009). In this case, there is no evidence that any computer software is "transferred" to ABC's customers. Indeed, ABC's customers do not have any control, custody, or possession over ABC's proprietary software which is used to provide its services.

ABC's position is further supported by a number of states, including STATE 4, STATE 5, and STATE 6, which have recently published sales and use tax guidance that services provided via a SaaS model constitute a nontaxable service.

It is important to note, that both STATE 5<sup>18</sup> and STATE 4,<sup>19</sup> like Illinois, include prewritten computer software in their definition of tangible personal property and both states tax electronically delivered or transferred prewritten computer software, but have nonetheless concluded that remotely accessed software is not subject to sales tax.

STATE 4. Consistent with its sales and use tax laws, the STATE 4 GOVERNMENTAL BODY issued guidance concluding that SaaS is not subject to sales and use tax in STATE 4 because it is not the sale of tangible personal property, but rather a service. See STATE 4. Technical Bulletin TB-72 (7/3/2013). STATE 4 defines "tangible personal property" to include prewritten computer software, including prewritten computer software delivered electronically. STATE 4 Rev. Stat. § 54:32B-2(g). As such, the Division reasoned that:

because SaaS only provides the computer with access to the software and the software is not "delivered electronically" it is not the sale of

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<sup>17</sup> On occasion, an API is provided to customers to access PRODUCT 1 at no charge to the customer. In addition, an Export API may also be provided to some customers for a fee. In either case, the API is incidental to the PRODUCT 1 service provided inasmuch as the true object of the transaction is the PRODUCT 1 service. See GIL ST 07-0066 (6/18/2007) ("the sale of a digital code delivered by electronic means should not be subject to Retailers' Occupation and Use Tax, because the [true] object of the transaction, the electronically delivered music or video recordings, is an intangible.")

<sup>18</sup> In STATE 5, "tangible personal property" is defined as "personal property which may be seen, weighed, measured, felt, or touched or which is in any other manner perceptible to the senses. Tangible personal property includes electricity, water, gas, steam, and prewritten computer software." STATE 5 Rev. Stat. § 77-2701.39. Further, the sale of computer software delivered electronically, i.e., via the Internet or online, to STATE 5 customers is subject to the sales and use tax regardless of the manner in which it is conveyed. STATE. Admin. R. & Regs. § 1-088.

<sup>19</sup> In STATE 4, the term "tangible property" includes prewritten computer software, including prewritten computer software delivered electronically. STATE 4 Rev. Stat. § 54:32B-2(g).

tangible personal property.... SaaS providers fully retain and operate the software applications to which they sell access. Customers only have access to the software through remote means. SaaS customers do not receive title or take possession of the software. The SaaS provider uses the software it owns or licenses to provide the service and does not transfer the software to its customer. A SaaS provider is not treated as a reseller of a license to use the software. Therefore, the sale of SaaS is not a sale of tangible personal property. Rather it is the sale of a service.

STATE 4 Technical Bulletin TB-72 at p. 2 (emphasis added).

STATE 5 On January 21, 2014, STATE 5 issued an updated version of its "Sales and Use Tax Guide for Computer Software," which addressed the taxability of various cloud computing services. See STATE 5. Sales and Use Tax Guide for Computer Software (updated 1/21/2014). The Guide defines the term "cloud computing" as "services which allow customers to access and use computer software, servers, operating systems, databases, and other computing resources via the Internet. Cloud computing includes services known as Software as a Service (SaaS), Platform as a Service (PaaS), and Infrastructure as a Service (IaaS)." *Id.* The Department further advised that "charges for services which allow customers to remotely access software applications, operating systems, servers, and other network components via the Internet or other online connections are not taxable. This is true regardless of whether the software, hardware, or network components are located in STATE 5 or outside the state." *Id.*

STATE 6. STATE 6 is the most recent state to offer clear guidance addressing the taxability [sic] certain cloud services, including SaaS. The STATE 6 GOVERNMENTAL BODY has amended Regulation 12 CSR § 10-109.050 (effective July 30, 2014), to specifically provide that SaaS is considered a nontaxable service. STATE 6. Code Regs. 10-109.050(2)(C). The Regulation defines SaaS as "a model for enabling ubiquitous, convenient, and on-demand network access to a shared pool of configurable computing resources (e.g., networks, servers, storage, applications, and services) that can be rapidly provisioned and released with minimal management effort or service provider interaction. The term includes platform as a service ("PaaS") model, infrastructure as a service ("IaaS") model, and similar service models. It does not include any service model that gives the purchaser the right to use specifically identified tangible personal property." STATE 6. Code Regs. 10-109.050(3)(1).

Other states like STATE 7 and STATE 8 have issued letter rulings which similarly conclude that services provided via SaaS model constitute the sale of nontaxable services, and not prewritten computer software.

STATE 7 The STATE 7 GOVERNMENTAL BODY recently issued Letter Ruling LR SUT 2014-05 (6/9/2014), discussing the sales and use tax treatment of a taxpayer's cloud computing services. The taxpayer provided cloud based applications and services to support a customer's telecommunication equipment, including its voice, video, messaging, presence, audio, web conferencing, and mobile capabilities. The software required for providing the services were [sic] installed on servers located outside the state. At no time was any software or application transferred to the customer, and the customer could not access the hosted software code nor manipulate the software in any way. The Department noted that "cloud collaboration services and hosting services"

were not enumerated taxable services in the state. The Department further found that, "Taxpayer's customers do not receive title to any hardware or software as part of the relevant transaction, nor do the customers receive use, possession or control of any hardware or software as part of the transaction. Thus, Taxpayer's sales of the services ... do not constitute taxable sales of hardware and/or software."

STATE 8. In STATE 8 Op. Ltr. O-2012-001 (2/6/2012), the taxpayer inquired whether STATE 8 sales tax applied to charges for "hosted software product" billed to STATE 8 physicians. The Department concluded that there was "nothing in the sales tax imposition statutes that supports taxing charges for hosted software." In addition, the Department stated that:

charges for hosted software services are not taxable as sales of "prewritten computer software" ... because the software that is installed on a remote server isn't delivered ... to subscribers or installed on their computers. The service provider has title and possession of the software. The department has ruled that any software that is delivered to a service subscriber that allows the subscriber access to the provider's remote application software is part of the non-taxable service. Such software is nontaxable as a sale of prewritten software so long as the software is not billed to subscriber as a separate line item charge.

STATE 8 Op. Ltr. O-2012-001 (2/6/2012).

In contrast, in some states such as STATE 9 and STATE 10, the courts intervened when the state taxing authorities have attempted to tax SaaS transactions as the taxable sale of tangible personal property (i.e., prewritten computer software) where there was no statutory support for such a position.

STATE 9. While a number of state taxing authorities have taken the position through administrative rulings and policy pronouncements that cloud based services involving remotely accessed software constitutes the sale of prewritten computer software, STATE 9 courts have rejected the STATE 9 GOVERNMENTAL BODY's classifications of cloud transactions as taxable sales of prewritten computer software. In *Thomas Reuters, Inc. v. Department of Treasury*, No. 313825 (Mich. Ct. App. 5/13/2014) (unpublished), the Court of Appeals reversed the ruling of the Court of Claims and held that access to Checkpoint, an online tax and accounting research tool did not constitute the sale of taxable prewritten computer software, but rather, constituted the provision of a service. The Court of Claims had reasoned that the case "involved an evolution of services, and because this product was taxable when it was in book or CD format, it was taxable now."

The Court of Appeals found the lower court's reasoning "unpersuasive." The Court of Appeals stated that "[A]ny transfer of tangible personal property was incidental to the service provided...Customers sought the expert knowledge of Checkpoint's content creators in synthesizing, compiling, and organizing the materials, thereby rendering research more efficient. There is no evidence that any de minimus amount of software transferred was the object of the transaction, or that customers sought to own or otherwise have responsibility for the prewritten computer software." The Court of Appeals also noted that the fact the license agreement entitles users to access and use

Checkpoint program does not establish that users primarily sought the physical software.

The *Thomas Reuter, Inc.* decision followed on the heels of the Court of Claims decision in *Auto-Owners Insurance Co. v. Department of Treasury*, Case No. 12-000082-MT (3/20/2014), in which the Court of Claims similarly held that an insurance company's access to a third party's software via the Internet was not subject to the state's use tax as a use of pre-written computer software. Rather, the court determined that the software-as-a-service transactions were properly characterized as a nontaxable service under the statute. In *Auto-Owners Insurance, Co.*, the Court of Claims ruled that mere access to the property did not constitute use because the taxpayer had not "exercised a right or power incident to ownership in the underlying software." In addition, the court noted that even if the pre-written software was delivered to and was used by the taxpayer, under the statute, that use was exempt from taxation because it was "merely incidental to the services rendered by the third-party providers and would not subject the overall transactions to use tax."

More recently, in *GXS Inc. v. Department of Treasury*, No. 13-000181-MT (March 4, 2015), the Michigan Court of Claims ruled that services provided by a taxpayer via software hosted on its own servers were not subject to Michigan use tax because they did not qualify as sales of prewritten software or taxable telecommunication services. The taxpayer provided services related to electronic data interchanges, the electronic translation and transformation of business documents, and the synchronization and storage of data. The Court noted that no software was installed or downloaded to customers' servers and that the transactions did not meet the requirements to constitute prewritten software, as there was no "delivery" to the taxpayer's customers.

STATE 10. The New York Division of Tax Appeals recently issued a decision *In Re SunGard Securities Finance LLC*, DTA No. 824336 (2/12/2014), refocused attention on the New York Department of Taxation and Finance's ("Department") aggressive approach toward taxing cloud based services involving remotely accessed software and treating the service as the direct or constructive possession of prewritten or "canned" computer software. Although the Department has consistently argued that an Application Service Provider's ("ASP") receipts are derived from providing customers with access and control of software, the Administrative Law Judge ("ALJ") carefully considered whether the customers actually use, direct, or control the ASP's software.

The ALJ ruled that SunGard's Smart Loan service, which was supported by an ASP agreement and involved the processing and maintaining of ancillary accounting ledgers in connection with the customer's securities lending and borrowing transactions, did not constitute the sale of prewritten software. The ALJ noted that under the ASP agreement, SunGard did not transfer, sell or license its Smart Loan software to its customers, nor did the customers have access to the software. The ALJ also noted that the Smart Loan service was only available during certain hours of the day, which was inconsistent with the purchase of prewritten software. Further, the ALJ concluded that the Smart Loan service was an exempt information service, as the information was personal and individual to the customer and was not furnished to others. This case is noteworthy because although the New York Division of Tax Appeals previously ruled in *In Matter of Voicemate.com*, Docket No., 819864 (6/2/2005), that the use of an ASP model to deliver services was not subject to tax as prewritten computer software

because the purchaser lacked control over the software, it was followed by a number of TBS's which set forth the Department's policy of treating the ASP model as the sale of prewritten computer software.

The STATE 9 decisions, along with the STATE 10 decisions *In Re Sungard Securities Finance LLC and Voicemate.com*, indicates that courts are rejecting the aggressive policy of some taxing authorities to classify cloud transactions as the taxable sale of prewritten computer software. Rather, these courts have properly concluded that cloud services, which provide access to software, constitute the nontaxable sale of services. In these cases, the state's sales tax laws clearly did not support the imposition of sales tax in connection with remotely accessed software.

In this case, the ROT laws simply do not support the imposition of tax on SaaS. The ROT is imposed on the retail sale of tangible personal property and not services. ABC is not engaged in the business of selling tangible personal property, but rather providing biomedical information and analysis services. Although it could be argued that ABC is providing its customers with taxable prewritten computer software, such a position is simply not supported by the ROT laws as there is no "transfer of ownership or title to" any prewritten computer software in this case. 35 ILCS 120/1. As the STATE 4 GOVERNMENTAL BODY aptly acknowledged in TB-72, "because SaaS only provides the customer with access to the software and the software is not "delivered electronically" it is not the sale of tangible personal property." STATE 4 Technical Bulletin TB-72 (7/3/2013). Similarly, ABC's SaaS model simply provides the customer with access to its proprietary software; it does not involve "any transfer of the ownership of or title to" the software. As such, the transaction cannot constitute a taxable "sale at retail" pursuant to 35 ILCS 120/1. ABC's customers do not receive title or take possession of the software at any time. Customers only have access to the software through remote means and may not control, direct, or modify the software. ABC fully retains, maintains and controls the proprietary software applications which they use to provide their services. Therefore, the services provided by ABC via a SaaS model are not a taxable retail sale of tangible personal property, but rather, the sale of a nontaxable service.

**B. Assuming arguendo, that ABC's PRODUCT 6, PRODUCT 7, and PRODUCT 3 are deemed to constitute "computer software," such software licenses constitute non-taxable retail sales pursuant to Ill. Admin. Code 130.1935(a)(1) and are not subject to the ROT.**

As discussed above, in Illinois, computer software (other than custom software programs) is statutorily defined as tangible personal property and its sale or use is taxable. See 35 ILCS 120/2. However, Illinois Administrative Code Section 130.1935(a)(1) specifically provides that 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.

Ill. Admin. Code 130.1935(a)(1). Therefore, software license agreements that meet the five-part test would not be subject to the ROT. For purposes of meeting these requirements, the Department has ruled that on-line check-the-box agreements do not constitute "a written agreement signed by the licensor and the customer" for purposes of Ill. Admin. Code 130.1935(a)(1)(A).<sup>20</sup> See Ill. Gen. Info. Letter No. ST 12-0011-GIL (2/29/2012). However, the Department's interpretation of this requirement appears to go beyond the plain language of the regulation. Indeed, there is no requirement in the regulation that the signature must be executed in hard copy form (i.e., with ink and paper), rather than in electronic form. Therefore, the Department's policy of denying the legal effect, validity, or enforceability of a signature solely on the ground that it is in electronic form has no basis in Illinois law. Further, such a superficial distinction would unduly discriminate against similarly situated taxpayers, simply based on the "form" of the signature used in executing the agreement. The Department has not discussed, nor does there appear to be, a rational basis for such a distinction.

The issue of whether an electronic signature would satisfy the requirement that the software license "is evidenced by a written agreement signed by the licensor and the customer," under Ill. Admin. Code 130.1935(a)(1)(A), was raised more than ten years ago in General Information Letter No. ST 04-0101 (6/24/2004). In that case, the taxpayer persuasively argued that electronic signatures with the appropriate safeguards should be deemed to meet the requirement. The Department, however, declined to issue a response to the ruling request.

It is important to note that since the issuance of General Information Letter No. ST 04-0101 (6/24/2004), technology has progressed ten-fold and it is more common than ever that software licenses are executed online by checking a box agreeing to the software's terms and conditions. In addition, since that time the Department has indicated its willingness to accept electronic signatures as it relates to other important tax documentation, such as exemption certificates. See GIL ST 08-0017 (2/21/2009) (electronic certificates of resale that contain electronic signature are acceptable).

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<sup>20</sup> In the present case, ABC concedes that it could not claim this exemption because it would fail to meet the requirement that the software license is "evidenced by a written agreement signed by the licensor and the customer. Ill. Admin. Code 130.1935(a)(1)(A). Typically, ABC's customers access its User Agreements online and customers check a box that states he or she accepts the terms of the subscription agreement.

Further, the Department has allowed the use of electronic signatures in connection with the filing of electronic returns, forms, and other documents. See Ill. Admin. Code tit. 86, § 760.230; Ill. Admin Code tit. 86, § 107.110.

The statutory basis for the Department to accept electronic signatures is provided pursuant to the Electronic Commerce Security Act, which was enacted in 1999. The purpose of the Act is "to facilitate and promote electronic commerce, by eliminating barriers resulting from uncertainties over writing and signature requirements, and promoting the development of the legal and business infrastructure to implement secure electronic commerce." 5 Ill. Comp. Stat. 175/1-105.

Section 5-120 governing "electronic signatures" provides in relevant part as follows:

Where a rule of law requires a signature, or provides for certain consequences if a document is not signed, an electronic signature satisfies that rule law...An electronic signature may be proved in any manner, including by showing that a procedure existed by which a party must of necessity have executed a symbol or security procedure for the purpose of verifying that electronic record is that of such party in order to proceed further with a transaction.

5 Ill. Comp. Stat 175/1-120.

Based on the foregoing it is clear that plain language of Ill. Admin. Code 130.1935(a)(1)(A) simply does not require that the signature be executed in hard copy form, rather than in electronic form, to meet the requirement. Further, Illinois' Electronic Commerce Security Act provides the Legislature's clear intent to "facilitate and promote electronic commerce, by eliminating barriers from uncertainties over signature requirements" and accepting the use of electronic signatures. 5 Ill. Comp. Stat. 175/1-105. In addition, the Department has already instituted the practice of accepting electronic signatures in connection with resale certificates and the submission of electronic returns, forms and other documents. See GIL ST 08-0017 (2/21/2009) (electronic certificates of resale that contain electronic signature are acceptable); see *a/so* Ill. Admin. Code tit. 86 §760.230; Ill. Admin. Code tit. 86, § 107.110.

Therefore, in the event the Department determines that ABC's PRODUCT 4, PRODUCT 2, and PRODUCT 3 constitute "computer software," ABC submits that such software licenses constitute non-taxable retail sales pursuant to Ill. Admin. Code 130.1935(a)(1) and are not subject to the ROT. ABC's PRODUCT 4, PRODUCT 2, and PRODUCT 3 meet the five-part test provided under Ill. Admin. Code 130.1935(a)(1) regardless of the fact that its software licenses are evidenced by a written agreement executed with an electronic signature:

- A. Although the PRODUCT 1, PRODUCT 2 and PRODUCT 3 services are evidenced by a written agreement signed by the licensor and the customer with an electronic signature, there is no statutory requirement that the agreement be signed in hard copy form;
- B. The PRODUCT 1, PRODUCT 2 and PRODUCT 3 agreements provide that customers do not exercise any control, custody or possession over

ABC's proprietary software,<sup>21</sup> thereby effectively restricting, the customer's duplication and use of the software;

- C. The PRODUCT 1, PRODUCT 2 and PRODUCT 3 agreements grants [sic] customers a limited nonexclusive, nontransferable license to access" COMPANY's proprietary software,<sup>22</sup> which essentially prohibits the customer from licensing, sublicensing or transferring the software to a third party;
- D. If access to the PRODUCT 1, PRODUCT 2 and PRODUCT 3 proprietary software is compromised, ABC provides support services for no charge and also will issue a new user ID and password for no charge; and
- E. At the end of a license period, customers would no longer have access to ABC's proprietary software.

Based on the foregoing, in the event the Department determines that ABC's PRODUCT 1, PRODUCT 2, and PRODUCT 3 constitute "computer software," ABC submits that such software licenses constitute non-taxable retail sales pursuant to the five-part test of Ill. Admin. Code 130.1935(a)(1) and are not subject to the ROT.

**C. Assuming *arguendo*, that ABC's PRODUCT 1, PRODUCT 2, and PRODUCT 3 constitute taxable "computer software," such sales would be sourced outside of Illinois and not subject to the Retailers' Occupation Tax.**

Assuming *arguendo* that the Department concludes that the transactions at issue constitute the sale of tangible personal property (i.e., the sale of prewritten computer software), ABC respectfully submits that such a transaction would not be subject to the Retailers' Occupation Tax based on the state's sourcing statutes and regulations.

By its nature, the Illinois' ROT was not intended to apply to services provided via a SaaS model. Thus, it is no surprise that Illinois' sourcing rules do not address such transactions. Generally, the ROT applies to retail sales of property located in Illinois at the time of the sale and then delivered in Illinois to the buyer. Ill. Admin. Code 86 § 130.605(a) provides as follows:

- (a) Where tangible personal property is located in this State at the time of its sale (or is subsequently produced in Illinois), and then delivered in Illinois to the purchaser, the seller is taxable if the sale is at retail.

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<sup>21</sup> See PRODUCT 1 User Agreement, at ¶ 2.a., Exhibit C; PRODUCT 2 User Agreement at ¶ 2.a., Exhibit D; PRODUCT 3 User Agreement, ¶ 2.a., Exhibit G.

<sup>22</sup> See *id.*

- (a)(1) The sale is not deemed to be in interstate commerce if the purchaser or his representative receives the physical possession of the property in this State.
- (a)(2) This is so notwithstanding the fact that the purchaser may, after receiving physical possession of the property in this State, transport or send the property out of the State for use outside the State or for use in the conduct of interstate commerce.
- (a)(3) The place at which the contract of sale or contract to sell is negotiated and executed and the place at which title to the property passes to the purchaser are immaterial. The place at which the purchaser resides is also immaterial. It likewise makes no difference that the purchaser is a carrier when that happens to be the case.

III. Admin. Code 86 § 130.605(a).

In addition, effective August 26, 2014, the Illinois Legislature enacted certain sourcing provisions to specify where a retailer is deemed to be engaged in the business of selling tangible personal property for the purposes of the Retailers' Occupation Tax Act, the Use Tax Act, the Service Use Tax Act, and the Service Occupation Tax Act, and for the purpose of collecting any other local retailers' occupation tax administered by the Department. ILCS Chapter 35 § 120/2-12. The provisions apply only to over-the-counter retail sales, purchases over the phone, in writing, or via the Internet, sales through vending machines, and sales of coal or other minerals mined in Illinois. *Id.*

The provision governing Internet sales provides as follows:

If a purchaser, having no prior commitment to the retailer, agrees to purchase tangible personal property and makes payments over the phone, in writing, or via the Internet and takes possession of the tangible personal property at the Retailer's place of business, then the sale shall be deemed to have occurred at the Retailer's place of business where the purchaser takes possession of the property if the retailer regularly stocks the item or similar items in the quantity, or similar quantities, purchased by the purchaser.

ILCS Chapter 35 § 120/2-12(2) (emphasis added).

Needless to say, it is difficult to apply Illinois sourcing rules to a transaction that was clearly not intended to be subject to the ROT. For example, the sourcing rule governing Internet sales assumes that the purchaser "takes possession of the tangible personal property." In the present case, the purchaser never takes possession of tangible personal property. Even if, for argument purposes, ABC's services constitute tangible personal property (i.e., computer software), under the statutory sourcing requirements of Section 120/2-12(2), ABC's customers would be deemed to take possession of the tangible personal property at ABC's place of business where it "regularly stocks the item or similar items in the quantity, or similar quantities, purchased by the purchaser." In other words, they would be deemed to take possession of the computer software at the

location of ABC's servers, which are located outside of the State of Illinois. As such, the Retailers' Occupation Tax would not apply to such a transaction.

Therefore, even if ABC's PRODUCT 1, PRODUCT 2, and PRODUCT 3 were to constitute taxable "computer software," such sales would not be subject to the ROT as these sales would be sourced outside of Illinois under the state's sourcing laws and regulations.

## V. Ruling Requested

Based on the forgoing, ABC respectfully requests that Department rule as follows:

1. ABC's PRODUCT 1, PRODUCT 2, and PRODUCT 3 services constitute non-taxable services and are not subject to the Retailers' Occupation Tax. See 35 ILCS 120/2; 35 ILCS 120/1; Ill Admin. Code 86 § 140.125(x).
2. In the event the Department determines that ABC's PRODUCT 1, PRODUCT 2, and PRODUCT 3 constitute "computer software," such licenses would be deemed non-taxable retail sales pursuant to Ill. Admin. Code 130.1935(a)(1) and are not subject to the Retailers' Occupation Tax.
3. Assuming *arguendo*, that ABC's PRODUCT 1, PRODUCT 2, and PRODUCT 3 constitute taxable "computer software," such sales would be sourced outside of Illinois, and therefore, not subject to the Retailers' Occupation Tax. See ILCS Chapter 35 § 120/2-12(2).

\* \* \* \* \*

ABC and its representative, FIRM, state that to the best of their knowledge, the Department has not previously ruled on the same or a similar issue for the taxpayer or a predecessor, and that ABC or any representative thereof, has not previously submitted the same or similar issue to the Department and withdrawn the request before a letter ruling was issued.

Thank you for your consideration of this important tax matter. If you have any questions, please do not hesitate to call me at ###.

In your email dated February 9, 2016, you state:

This is in response to your previous inquiry regarding the function of the APIs:

- The API allows customers to automatically send data directly from their software platform, to PRODUCT 1, for example.
- The Export API allows customers to export their analysis results from PRODUCT 1 into another format, such as a data file which the customer can then use for further processing.
- Once a customer no longer purchases the PRODUCT 1 service and cannot access the PRODUCT 1 service, the API or Export API will no longer function.

- The API or Export API cannot be used in any other way once the PRODUCT 1 service is discontinued.
- Providing an Export API to a customer for a fee is actually a new product offering without a SKU and there are no customers as of this time. As a result, the company does not have any sample invoices which it can provide. The company developed this product as a consulting project with another customer and are still in the process of “productizing” the Export API offering.

In your email dated April 19, 2016, you state:

Sorry for the delay. We have confirmed with the client that the API is downloaded onto the customer’s computer.

As you may know, several jurisdictions have addressed the issue of whether the download of “API-type” software (e.g., API, local client, desk top agent, etc.) potentially taints an otherwise non-taxable service transaction. In fact, the Michigan Court of Appeals recently addressed this issue in Auto Owners Insurance Co., v. Dept. of Treasury, Docket No. 321505 (Mich. App. 2015) (see attached). In Auto Owners, the taxpayer sought a refund of use tax erroneously paid to the Michigan Department of Revenue (“Department”) on the purchase of certain nontaxable services. The Department argued that the provision of such services constituted the taxable sale of prewritten computer software and was subject to use tax. Auto Owners argued that the products at issue did not constitute prewritten computer software and that any software involved was incidental to the services provided.

Although the Court found that some prewritten computer software was electronically delivered to Auto Owners, the Court ruled that the electronic delivery of a “local client” or “desktop agent” was merely incidental to the vendor’s rendering of professional services. The Court noted that, “plaintiff contracted with the businesses in order to receive services, and the tangible personal property were merely incidental to the provision of services. There is no indication that plaintiff could purchase the software or other tangible personal property independent of the services, and the services gave value to the software and other tangible personal property.” In Auto Owners Insurance Co., v. Dept. of Treasury, Docket No. 321505 at p.14. Therefore, the Court held that the transactions at issue were not subject to use tax. Id.

Similarly, in this case the API is merely incidental to the services provided by Ingenuity. The API has absolutely no functionality or value independent of the PRODUCT 1 services by Ingenuity. The API cannot be used in any other way once the PRODUCT 1 service is discontinued.

#### **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). 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 question.

### Sales 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 Transactions:

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 purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. 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 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.

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.

It appears from your letter that the Company is making sales of service and is a serviceman. As a serviceman, the Company does not incur Retailers' Occupation Tax. Service Occupation Tax is imposed upon all persons engaged in the business of making sales of service on all tangible personal property transferred incident to a sale of service, including computer software (35 ILCS 115/3), and is calculated as explained above. Currently, 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. The Department continues to review cloud-

based arrangements. If, after review, the Department determines that these transactions are subject to tax, it will only apply this determination prospectively.

You state in your letter that the Company does not license or lease any software or tangible personal property to the customer. However, your letter and subsequent emails state that the customer receives an application program interface (API) as part of the service. In one of the emails we received, you confirm the API is downloaded onto the customer's computer. Computer software is defined broadly in the Retailers' Occupation Tax Act. If a provider of a service provides to the customer an API, applet, desktop agent, or a remote access agent to enable the customer to access the provider's network and services, it appears the customer is receiving computer software. Although there may not be a separate charge to the customer for the computer software, it is nonetheless subject to tax, unless the transfer qualifies as a non-taxable license of computer software. If the provider, as a serviceman, is not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act and qualifies as a de minimis serviceman, the provider could elect to pay Use Tax on its cost price of the computer software.

You argue the computer software delivered to a customer is incidental to the service and should not be subject to tax. As explained above, under the Service Occupation Tax Act, a tax is imposed on making sales of service on all tangible personal property transferred as an incident to sales of service, including computer software. If a transaction does not involve the transfer of any tangible personal property to the customer, then it generally would not be subject to Service Occupation Tax. Because the tax is imposed on the tangible personal property transferred as an incident to sales of service, all tangible personal property transferred as an incident to sales of service is subject to tax, whether or not the tangible personal property was only incidental to the sale of service.

I hope this information is helpful. If you have further questions related to the Illinois sales tax laws, please visit our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Debra M. Boggess  
Associate Counsel

DMB:bkI