Treasury and IRS release proposed regulations addressing the classification of digital transactions


Carol P. Tello, Partner
Brian Tschosik, Associate
Background
Treas. Reg. § 1.861-18

— Proposed in 1996 and finalized in 1998, the -18 regulations are guided by principles of US copyright law, with certain exceptions

— Distinction between transfer of copyright right (intangible personal property and copyrighted article (tangible personal property)
  • Transfer of a copyright right is any of the following:
    1. The right to make copies of the computer program for purposes of selling the copies to the public;
    2. The right to create derivative works from the computer program;
    3. The right to make a public performance of the computer program; and
    4. The right to publicly display the computer program.

— If none of these rights are transferred, the transfer is characterized as the transfer of a copyrighted article

— A copyrighted article is further classified as either a sale or lease based on whether the benefits and burdens of ownership have passed to the transferee
Prop. Treas. Reg. § 1.861-18

Transfers of computer programs

— Expands scope of Treas. Reg. § 1.861-18 to cover all transfers of digital content
  • Digital content: any content in digital format that is either protected by copyright law or no longer protected by copyright law due to the passage of time

— New sourcing rules:
  • Sale is deemed to occur at the location of the download or installation on the end user’s device; or
  • The location of the customer
Cloud transactions

- Cloud transactions: Transactions through which a person obtains on-demand network access to computer hardware, digital content, or similar resources.

- Cloud transactions are further classified as services or a lease based on the factors in section 7701(e)(1):
  - Physical possession of the property;
  - Control of the property;
  - Significant economic or possessory interest in the property;
  - No risk of substantially diminished receipts or increased expenses from nonperformance under the contract;
  - No concurrent use of the property; and
  - Whether the total contract price exceeds the rental value of the property for the contract period.

- Proposed regulations do not contain sourcing rules for cloud transactions.
Examples
Streaming, renting and purchase of digital content

Media company

Video streaming, rentals and purchases

End user
Examples
Transfers of digital media

Copyright owner

Distribution rights

e-Book distributor

License agreement

End user