distribution of Property X to Partner A, and the increase to the basis of Property X by $10 million in Partner A's hands, ABC Partnership is required to reduce the adjusted basis of its remaining properties under section 734(b)(2)(B) by $10 million. Partner B's and Partner C's share of ABC Partnership's basis decrease to its remaining properties is $5 million each. Neither Partner A nor ABC Partnership engages in any other transaction described in paragraph (c) of this section for taxable year 2025.

(ii) *Analysis.* For purposes of paragraphs (c)(1)(ii) and (c)(3)(i) of this section, under paragraph (c)(3)(iv) of this section, only $5 million of the $10 million basis increase to Property X counts toward the applicable threshold because $5 million of the basis increase corresponds to unrelated Partner C's share of the decrease to the basis of ABC Partnership's remaining properties under section 734(b)(2)(B) and thus, is excluded from the calculation of the applicable threshold. Thus, the distribution of Property X to Partner A is not a transaction described in paragraph (c)(1)(ii) of this section with respect to either Partner A or ABC Partnership because the applicable threshold is not met for taxable year 2025.

(h) *Extension of time—(1) Taxpayer disclosures.* Taxpayers will be treated as having met their requirements to disclose timely under § 1.6011–4(e)(2)(i) if they file their disclosure with the OTSA by July 14, 2025.

(2) *Material advisor disclosures.* Material advisors who have made a tax statement before January 14, 2025 will be treated as having met their requirements to disclose timely under § 301.6111–3(e) of this chapter if they file their disclosure with the OTSA by the date that is an additional 90 days beyond the last day for filing specified in § 301.6111–3(e) of this chapter.

(i) *Applicability date*—(1) *In general.* This section's identification of transactions that are the same as or substantially similar (within the meaning of § 1.6011–4(c)(4)) to the transactions described in paragraph (c) of this section as transactions of interest for purposes of § 1.6011–4(b)(6) and sections 6111 and 6112 of the Code is effective January 14, 2025.

(2) *Material advisors.* Notwithstanding § 301.6111–3(b)(4)(i) and (iii) of this chapter, material advisors are required to disclose only if they have made a tax statement on or after January 14, 2019.

Douglas W. O'Donnell,

Deputy Commissioner.

Approved: January 3, 2025.

Aviva R. Aron-Dine,

Deputy Assistant Secretary of the Treasury (Tax Policy).

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 10022]

RIN 1545–BM41

Classification of Digital Content Transactions and Cloud Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations modifying the rules for classifying transactions involving computer programs, including by applying the rules to transfers of digital content. These final regulations also provide rules for the classification of cloud transactions. These rules apply for purposes of the international provisions of the Internal Revenue Code and generally affect taxpayers engaging in transactions involving digital content or cloud transactions.

DATES:

Effective date: These regulations are effective on January 14, 2025.

Applicability date: For dates of applicability, see §§ 1.861–18(i) and 1.861–19(e).

FOR FURTHER INFORMATION CONTACT: Christopher E. Fulle, (202) 317–5367, or Michelle L. Ng, (202) 317–6989 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Authority

These final regulations are issued under the express delegation of authority under section 7805 of the Internal Revenue Code (Code). Section 7805(a) directs the Secretary of the Treasury or her delegate to prescribe all needful rules and regulations for the enforcement of that section and others in the Code, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

Background

On August 14, 2019, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) published proposed regulations (REG–130700–14) under section 861 of the Code in the **Federal Register** (84 FR 40317) (the proposed regulations). The Treasury Department and the IRS received written comments on the proposed regulations, and a public hearing was held on February 11, 2020. All written comments received in response to the proposed regulations are available at *www.regulations.gov* or upon request. Terms used but not defined in this preamble have the meaning provided in these final regulations.

These regulations (the final regulations) extend the classification rules in existing § 1.861–18 to transfers of digital content other than computer programs and clarify the source of income for certain transfers of digital content. The final regulations also clarify the classification of transactions involving on-demand network access to computing and other similar resources.

The final regulations retain the overall approach of the proposed regulations, with certain revisions discussed in the preamble. The preamble also discusses comments received in response to the solicitation of comments in the notice of proposed rulemaking.

Summary of Comments and Explanation of Revisions

I. General Classification Issues

A. Replacement of De Minimis Rule With a Predominant Character Rule

Section 1.861–18(b)(1), as in effect before this Treasury decision, described four transactions involving computer programs: the transfer of a copyright right, the transfer of a copyrighted article, the provision of services for the development or modification of a computer program, and the provision of know-how relating to the development of a computer program. Section 1.861–18(b)(2) required any transaction that consisted of more than one of the transactions described in § 1.861–18(b)(1) to be treated as separate transactions, unless a transaction was de minimis, in which case it would be treated as part of another transaction. The proposed regulations generally retained the four types of transactions (with the expansions described in Part II.A of this Summary of Comments and Explanation of Revisions) and preserved the de minimis rule, but for clarification purposes, § 1.861–18(b)(2) was proposed to be modified by introducing the term

''arrangement'' and providing that multiple transactions in an arrangement generally must be characterized separately.

Proposed § 1.861–19(b) defined a cloud transaction as a transaction through which a person obtains on-demand network access to computer hardware, digital content (as defined in proposed § 1.861–18(a)(3)), or other similar resources, other than on-demand network access that is de minimis taking into account the overall arrangement and the surrounding facts and circumstances. Similar to proposed § 1.861–18(b)(2), proposed § 1.861–19(c)(3) required separate classification of each transaction comprising an arrangement, except that any transaction that was de minimis would be treated as part of another transaction rather than being classified separately.

Comments recommended replacing these rules in proposed §§ 1.861–18(b)(1) and (b)(2), and 1.861–19(c)(3), with a predominant character rule, such that a transaction consisting of more than one category of transactions described in proposed § 1.861–18(b)(1), or a transaction consisting of one or more categories of transactions described in both proposed §§ 1.861–18(b)(1) and 1.861–19(b), would be characterized as only one of those categories of digital content transactions or as a cloud transaction in accordance with the predominant character of that transaction. As an example of a mixed transaction that would be difficult to characterize under the proposed regulations, comments pointed to video game business models where the customer purchases a copy of the game but primarily plays the video game online with other players. As another example, comments pointed to software antivirus programs that include code that executes on the user's equipment as well as code that is deployed in the cloud to detect and capture viruses before they reach the user's equipment. The comments argued that the predominant character rule would avoid the difficult and burdensome task of determining whether an element is de minimis in the context of the overall transaction and allocating income from the transaction among the non-de minimis categories as if they were separate transactions. The comments also argued that a de minimis standard is imprecise, and a predominant character rule that compares components of a transaction to determine which component is predominant would be much more administrable. Furthermore, one comment suggested that a predominant character standard would better align with existing Treasury regulations and other authorities, for instance, § 1.954–1(e)(3), which provides for a predominant character approach in the subpart F context. Finally, the comments noted confusion arising from the use of the term ''transaction'' to mean two different things in the same provision under proposed § 1.861–18(b)(2), and also recommended removing the term ''arrangement'' on the grounds that the term was unclear, particularly because it was not defined and rarely appears in other tax rules.

The comments recommended that the predominant character of a transaction be determined based on the facts and circumstances. Comments suggested that the relevant facts may include the overall commercial purpose, the taxpayer's treatment for non-tax purposes, the relative cost of each component (including the cost of maintaining online and offline components), and a comparison of unit prices for components sold separately. Comments suggested that the facts and circumstances should provide at least a reasonable basis for determining the predominant character of the transaction.

Further, the comments suggested defining a transaction based on the facts and circumstances or as an agreement entered into in the ordinary course. Several comments suggested that relevant factors for determining the scope of a transaction could include the availability of separate pricing, the use of separate stock keeping units (''SKUs''), and the taxpayer's definition for non-tax purposes.

The final regulations adopt these comments, in part. The final regulations replace the de minimis rule and the concept of an arrangement with a predominant character rule, which applies to both digital content transactions and cloud transactions. The Treasury Department and the IRS agree that, for purposes of the final regulations, a transaction with multiple elements (including de minimis elements) should be characterized based on the predominant character of the transaction. Predominant character rules also exist in other regulations for international provisions of the Code, such as foreign-derived intangible income and subpart F, and thus are familiar to taxpayers. *See* §§ 1.250(b)–3(d) and 1.954–1(e)(3). Further, in many business models that include both online and offline functionality it may be difficult to bifurcate a single transaction into a digital content transaction and a cloud transaction. The Treasury Department and the IRS expect that bifurcation will remain difficult and may increase in difficulty as business models and technology evolve. Therefore, § 1.861–18(b)(2) of the final regulations provides that, taking into account the overall transaction and the surrounding facts and circumstances, a transaction that has multiple elements, one or more of which would be a digital content transaction if considered separately, is classified in its entirety as a digital content transaction under one of the categories described in § 1.861–18(b)(1) if the predominant character of the transaction is described in one of the categories in that paragraph. Section 1.861–19(c)(2) of the final regulations provides a corresponding rule for transactions that have multiple elements, one or more of which is a cloud transaction. Further, the references to ''de minimis'' and ''arrangement'' are also removed in § 1.861–19(a) of the final regulations so that the final regulations define a cloud transaction as a transaction through which a person obtains on-demand network access to computer hardware, digital content (as defined in § 1.861–18(a)(2)), or other similar resources.

The final regulations define a digital content transaction as a transaction that constitutes a transfer of digital content or the provision of modification or development services or of know-how with respect to digital content. *See* § 1.861–18(b)(1). The final regulations do not, however, define the term transaction. The Treasury Department and the IRS have concluded that it is not necessary to introduce a specialized definition in these regulations because the concept is already well-established under general tax principles, case law, and existing administrative guidance.

Section 1.861–18(b)(3) of the final regulations (cross-referenced in § 1.861–19(c)(2)) provides a general rule and a special rule for determining the predominant character of a transaction that contains multiple elements, one or more of which would be a digital content transaction or a cloud transaction if considered separately. Under the general rule, the predominant character is determined by the primary benefit or value received by the customer. If that information is not reasonably ascertainable, the special rule provides that the predominant character is determined by the primary benefit or value received by a typical customer in a substantially similar transaction, which is determined by data on how a typical customer uses or accesses the digital content. If data on how a typical customer uses or accesses the digital content is not available, then all factors indicative of the primary benefit or value received by a typical

customer must be examined, including how the transaction is marketed, the relative development costs of each element of the transaction, and the relative price paid in an uncontrolled transaction for one or more elements compared to the total contract price of the transaction in question.

B. Distinction Between Temporary Downloads and Streaming

One comment requested guidance on ''streaming'' and ''temporary downloading'' transactions. The comment expressed the view that whether a customer can download digital content should not determine whether a transaction is characterized as a service or a lease. The comment noted that when a customer's rights are limited to downloading and viewing a discrete item of digital content, such as a movie, for a limited time, the transaction would be treated as a lease of digital content. However, if the customer can access and download as many movies as desired from a catalog of thousands of movies for a monthly fee, and once the subscription ends access to the downloaded movies ends, the transaction would be treated as a cloud transaction and classified as a service according to the comment. The comment suggested that the characterization of these two transactions should not depend on whether the content is actually downloaded by any particular customer.

Another comment asserted that on-demand access to digital content should not be treated differently than temporary downloads of digital content because the two transactions are functionally equivalent in that both provide temporary access to digital content. The comment observed that the decision to provide on-demand access or temporary downloads of digital content is typically driven by the nature of the technology involved (for example, the memory capacity of a user's computer or the download speeds available), and generally has no bearing on the economic substance of the transaction.

Where the provider chooses whether to offer either temporary downloads or streaming the Treasury Department and the IRS disagree that these two types of transactions should be treated the same. A fundamental requirement of a digital content transaction, unlike a cloud transaction involving digital content, is that there must be a transfer of digital content to the customer. This distinction between property and services transactions has been in place since the original issuance of § 1.861–18 in 1998 and applying it consistently provides a degree of certainty for an otherwise factual case-by-case determination.

When a customer downloads digital content, there is a transfer of a copy of that digital content to the customer and the customer must use its own device to host the copy of content for viewing or listening, for example. In contrast, when a customer streams digital content, there is no transfer of digital content. Instead, the customer receives access to the digital content through the provider's servers. Especially for large file-size content, performing the hosting function in order to allow the customer continuous access places a higher burden on the provider. Similarly, for a temporary download, the customer must have sufficient storage on its device for the temporary download that is not necessary in a streaming transaction. There are also differences in how the customer may experience the digital content. For example, once a customer downloads digital content, the customer is able to access the content regardless of whether the customer is connected to the internet and could thus watch a downloaded movie or read a downloaded book when the customer is unable to connect to the internet. In these ways, there are fundamental differences in character between a temporary download and streaming that warrant different characterization and sourcing rules for each type of transaction. Where the customer may choose whether to temporarily download or stream content, the predominant character rule in the final regulations would apply to characterize the transaction. *See* § 1.861–19(d)(7) (Example 7) and (d)(9) (Example 9) of the final regulations.

II. Transactions Involving Digital Content

A. Definition of Digital Content

Section 1.861–18, as in effect before this Treasury decision, applied only to computer programs. The proposed regulations expanded the scope of § 1.861–18 to apply to transactions involving ''digital content,'' defined as ''a computer program or any other content in digital format that is either protected by copyright law or no longer protected by copyright law solely due to the passage of time.''

Several comments recommended broadening the definition of digital content to encompass content not protected by copyright law that is transferred electronically and is similar to copyrightable content, such as consumer or user data, text files of recipes, government-produced documents, and sets of font and typefaces. One comment suggested expansion to any property in digital format in which a person has a right or interest, including any property bought and sold in real marketplaces, in virtual marketplaces and in in-game economies. These comments generally suggested that transfers of this non-copyrightable digital property are economically and functionally equivalent to the transfer of digital content and that characterization of the transfers should be treated the same. One comment asserted that such content may be subject to other forms of intellectual property protection such as contractual restrictions and non-disclosure agreements, such that transfers of that content are functionally similar to transfers of digital content.

The final regulations do not broaden the definition of digital content beyond content protectable by copyright law. Section 1.861–18, as in effect before this Treasury decision, generally followed copyright law, and the Treasury Department and the IRS are of the view that it is appropriate to continue to apply this longstanding copyright law framework. This framework is not workable for non-copyrightable content given that the legal rights associated with such content generally are not the same as those associated with content protectable by copyright law. For example, in a digital transfer of property that is not protected by copyright law, the transferee may (unless otherwise restricted, such as by contract) have the unfettered ability to make and distribute copies to the public, to prepare derivative works, or to publicly display or publicly perform the property. As a result, if the framework of § 1.861–18 were applied to the transaction, such a transfer would generally be characterized as a license or sale of a copyright right, regardless of whether the transferee intends to exploit those abilities or whether those powers have any value or relevance in the context of the transaction. Therefore, the existing framework could result in a classification at odds with the economics and reality of the transaction. Further, where non-copyrightable digital property is transferred subject to contractual or other restrictions, those restrictions may not fit cleanly within the existing framework and may require a different analysis to determine the correct characterization. Accordingly, including non-copyrightable content would require a different set of rules that are beyond the scope of § 1.861–18.

One comment noted that under the proposed regulations, an online database that allows customers on-demand access to a collection of non-

copyrightable content such as recipes or court opinions is a cloud transaction. *See* § 1.861–19(d)(8) (Example 8). This is because the definition of a cloud transaction in proposed § 1.861–19(b) refers to on-demand network access to computer hardware, digital content, or ''other similar resources.'' The comment suggested that the inclusion of ''other similar resources'' in the definition of cloud transaction may provide a road map for expanding the definition of digital content in proposed § 1.861–18. The Treasury Department and the IRS disagree. The cloud transaction definition includes access to non-copyrightable content because curation of such content is a common business model that, unlike the framework of § 1.861–18, does not depend on whether the content is copyrightable because there is no transfer to the customer.

The final regulations therefore do not adopt these comments and continue to characterize digital content transactions based on the distinction between a transfer of a copyrighted article and a transfer of copyright rights, which depends on whether the customer receives copyright rights as part of the transfer. The Treasury Department and the IRS may, however, consider these comments for possible future guidance specific to types of digital property that are not protectable by copyright law. The final regulations do provide, however, that digital content includes content that is not protected by copyright law solely because the creator dedicated the content to the public domain. The regulations include this refinement because monetization of such content generally also involves digital content that is protected by copyright law and therefore fits within the framework of § 1.861–18. *See* § 1.861–18(a)(2).

B. Provision of Know-How Relating To Development of Digital Content

Section 1.861–18(b)(1)(iv), as in effect before this Treasury decision, provided that one of the categories of transactions relating to computer programs was ''[t]he provision of know-how relating to computer programming techniques.'' Section 1.861–18(e) provided that the provision of information with respect to computer programs will be treated as the provision of know-how for purposes of § 1.861–18 only if the information (1) relates to computer programming techniques; (2) is furnished under conditions preventing unauthorized disclosure, specifically contracted for between the parties; and (3) is considered property subject to trade secret protection. The proposed regulations would modify § 1.861–18(b)(1)(iv) and (e)(1) by replacing ''computer programming techniques'' with ''development of digital content,'' but would not otherwise change § 1.861–18(b)(1)(iv) and (e)(1).

One comment asked for confirmation that the changes to § 1.861–18(b)(1)(iv) and (e)(1) would not change the scope of § 1.861–18(b)(1)(iv), and that § 1.861–18(b)(1)(iv) in the final regulations describes only know-how transferred under terms that constitute a license for United States Federal tax purposes. The Treasury Department and the IRS confirm that § 1.861–18(b)(1)(iv) in the proposed and final regulations is intended to describe the same type of know-how covered by § 1.861–18(b)(1)(iv) as in effect before this Treasury decision, except that know-how may relate to any development of digital content and not merely computer programming techniques. The Treasury Department and the IRS have determined that § 1.861–18(b)(1)(iv) and (e)(1) are sufficiently clear in this regard and that additional guidance on the treatment of such know-how is unnecessary.

C. Rights To Prepare Derivative Digital Content

Section 1.861–18(c)(2)(ii), as in effect before this Treasury decision, provided that one of the copyright rights referred to in that paragraph was the right to prepare derivative computer programs based upon a copyrighted computer program. The proposed regulations would replace the references to computer programs with references to digital content but would not otherwise change § 1.861–18(c)(2)(ii). One comment recommended that the right to prepare derivative digital content based upon digital content should be treated as a copyright right only if it is coupled with the right to distribute the derivative digital content to the public. The comment expressed the belief that this change would be consistent with one of the underlying policies of these regulations, which is to treat as a license a transaction in which the transferee exercises a copyright right to exploit the rights in the market, and to treat as a sale or lease a transaction in which the transferee consumes the digital content. The comment also suggested that this change would address the ambiguity in copyright law as to what modifications of a copyrighted work are necessary to create a derivative work, and whether, for example, rights to modify software during installation or customization would constitute rights to create a derivative work.

The final regulations do not adopt this comment. The preamble to Treasury Decision 8785 (which promulgated § 1.861–18 in 1998) stated in response to similar comments to the proposed regulations (REG–251520–96) that were finalized in Treasury Decision 8785 that the right to make copies (which must be coupled with the right to distribute the copies to the public to constitute a copyright right under the regulations, despite such a requirement not being present under copyright law) is treated differently from the other copyright rights in the context of the regulations because of the unique characteristics of computer programs, including the ease with which computer programs can be copied. However, as explained in that preamble, it is generally consistent with copyright law to treat as a copyright right a non-de minimis right to make a derivative work, regardless of whether it is coupled with the right to distribute to the public, and there is no sufficiently unique aspect of digital content that would compel a different result for purposes of § 1.861–18. The Treasury Department and the IRS continue to be of the view that that the right to make a derivative work without further rights to distribute to the public should be treated as a copyright right and that the unique characteristics of digital content do not compel a different result. However, the predominant character rule in § 1.861–18(b)(2) and (3) of the final regulations (discussed in Part I.A of this Summary of Comments and Explanation of Revisions) should alleviate concerns about minor customization rights causing what would otherwise be a transfer of digital content to be treated as a license of a copyright right. *See* § 1.861–18(h)(18) (Example 18) of the final regulations.

D. Right To Make a Public Performance or Public Display for Purposes of Advertising

Section 1.861–18(c)(2), as in effect before this Treasury decision, designated as copyright rights the right to make a public performance of a computer program and the right to display a computer program to the public. The proposed regulations would replace the references to computer programs with references to digital content, and also provide exceptions for the right to publicly perform or publicly display digital content for the purpose of advertising the sale of the digital content performed or displayed. Proposed § 1.861–18(c)(2)(iii) and (iv). The preamble to the proposed regulations used an example of rights provided to a video game retailer that allow the retailer to display screenshots of a video game on television commercials promoting the game, and

noted that these rights, on their own, would not be significant. Two comments agreed with the addition of the regulatory language and one of the comments suggested that the preamble example be included in the regulatory text.

The final regulations retain the exceptions for the public performance or public display of digital content for the purpose of advertising the sale of the digital content performed or displayed. *See* § 1.861–18(c)(2)(iii) and (iv). The Treasury Department and the IRS have determined, however, that the language of the regulation is sufficiently clear without an example and therefore the final regulations do not include the example in the regulatory text.

E. Copyright Rights Related to Digital Content Used for Cloud Transactions

One comment questioned whether the transfer of the right to use software or other digital content for a cloud transaction should be treated as the transfer of a copyright right. The comment included an example wherein A, a domestic corporation, transfers computer software to B, a foreign affiliate. B also gets the right to use the software to provide software-as-a-service transactions, but does not get the right to sell copies of the software or make derivative works. The comment stated that it appears that a copyright right has been transferred in this scenario, but that it is not clear which of the enumerated copyright rights is transferred. The comment recommend that the final regulations allow taxpayers to elect to characterize this type of transaction as a transfer of a copyright right.

The Treasury Department and the IRS agree that a transfer of digital content accompanied by the right to use the digital content to provide a cloud transaction will generally result in the transfer of the right to either publicly display or publicly perform the digital content, depending on the type of digital content and specific rights transferred. To display a work means to show a copy of it, either directly or by means of a film, slide, television image, or any other device or process or, in the case of a motion picture or other audiovisual work, to show individual images nonsequentially. 17 U.S.C. 101. To perform a work means to recite, render, play, dance, or act it, either directly or by means of any device or process or, in the case of a motion picture or other audiovisual work, to show its images in any sequence or to make the sounds accompanying it more audible. *Id.* Further, 17 U.S.C. 101 includes a ''transmit clause'' that provides that to publicly display or perform a work means, in relevant part, to transmit or otherwise communicate a performance or display of the work to the public, by means of any device or process, whether the members of the public capable of receiving the performance or display receive it in the same place or in separate places and at the same time or at different times. Reading these provisions of 17 U.S.C. 101, the Treasury Department and the IRS have concluded that the use of digital content to provide a cloud transaction should be treated as the exercise of a copyright right under both copyright law and the final regulations. *See American Broadcasting Companies, Inc.* v. *Aereo, Inc.,* 573 U.S. 431 (2014) (holding that capture of broadcast copyrighted content and retransmission to subscribers who stream the content to their personal devices was a public performance of a copyrighted work under the transmit clause of 17 U.S.C. 101). However, whether the transferred right is a right to display or a right to perform will depend on the type of digital content, the type of copyright obtained, and the manner in which the digital content is used in the cloud transaction. Due to the factual nature of these issues and the important role of copyright law in those determinations, the final regulations do not specify which copyright right has been transferred when digital content is transferred for use in a cloud transaction.

F. Examples Illustrating § 1.861–18

Several comments requested new examples describing common business models or modifications to examples provided in the proposed regulations. In response to these comments, the final regulations contain several new examples and make certain modifications to the examples in the proposed regulations. In addition, pre-existing examples that were in effect before the issuance of this Treasury decision have been modified to follow the same analytical structure as the examples added by the final regulations.

One comment requested an example of a wholesaler of computer software buying and selling a limited number of product keys. A product key is a specific software-based key for a computer program that certifies the copy of the program is original. Instead of using physical media such as a CD or DVD to install software onto a computer or other electronic device, a user can enter a product key to download the software and then install it from their computer's hard drive. A customer that purchases software through electronic channels often receives a link to download and a product key to activate the software. The comment asserted that an underlying principle of these regulations is to treat economically similar income equally, regardless of whether the income is earned through electronic means or through more conventional channels of commerce, and therefore the income earned by a wholesaler of product keys for software should be treated the same as a wholesaler of physical copies of software. The Treasury Department and the IRS agree that § 1.861–18 does not characterize otherwise similar transactions differently solely because one transaction was effected through electronic means and the other was not. *See* § 1.861–18(g)(2) of the final regulations. In response to the comment, a new example added in the final regulations, § 1.861–18(h)(24) (Example 24), addresses a business model in which a video game copyright owner transfers product keys to retailers, and then the retailers transfer those keys to customers. Based on the facts in the example, the transfer of product keys to the retailers is characterized as a sale of copyrighted articles, and the transfer of product keys from the retailers to customers is also classified as the sale of copyrighted articles.

Two comments asked for an example addressing a business model in which an operator of a platform offers for download digital content (for example, video games or electronic books) as an agent of the digital content developers. The platform operator receives the copyright right to make and sell digital copies of the digital content, but this right is granted only so that the platform operator can act in its capacity as an agent facilitating sales of the digital content between digital content developers and customers. As such, the comments asserted that the transaction between the platform operator and digital content developers should not be treated as the transfer of copyright rights. One of these comments also suggested several clarifying changes to proposed § 1.861–18(h)(19) (Example 19) to distinguish the business model described in that example, which involves a licensed reseller that utilizes an online platform, from the agency platform operator described in the comment.

The Treasury Department and the IRS recognize that an agency platform operator business model exists, and therefore the final regulations include a new example at § 1.861–18(h)(20) (Example 20) that describes a scenario in which a platform operator offers applications for sale as an agent of the

application developers. The facts in Example 20 assume that the platform operator acts as an agent of the application developers under general tax principles and concludes that the characterization of the transaction between the platform operator and application developers is not a digital content transaction nor a cloud transaction. Whether a taxpayer is acting as an agent on behalf of another taxpayer is determined under general tax principles and that determination is outside the scope of these final regulations. Additionally, § 1.861–18(h)(19) (Example 19) of the final regulations contains certain changes to the facts in the proposed regulations that are intended to distinguish the licensed reseller platform operator business model described in that example from the agency platform operator model described in Example 20, namely that the primary benefit or value that the distributor (Corp A) receives in the transaction in Example 19 is the right to reproduce and distribute an unlimited number of copies of the book.

One comment recommended adding an example describing a business model in which a video game that can be played on a particular game console or a computer is sold in physical copies through retailers, or digitally through the game console's store or through an internet store for a one-time fee. The game's core functionality is accessed online and, if played on the game console, requires paying an annual or monthly subscription fee to the console maker which grants the customer access to the online functionality of the console, thereby allowing the customer to play the online component of the video game (and all other video games) on the console. This fee is charged by the console maker for purposes of using the console online, so if the game is played on a computer, there is no additional fee to access the online content. The example in the comment concluded that the purchase of the console version of the video game, whether from a retailer, the game console store, or the internet store, is a cloud transaction because most customers purchase the game primarily to enjoy the online functionality. This comment also recommended another similar example, except the core functionality of the video game is offline content, and therefore the purchase of the video game is the sale of a copyrighted article.

The comment underscores the fact that there are many different business models and types of transactions in the video game industry. The determination of the character of each transaction will necessarily be fact-specific based on the rights obtained by the customer and, if relevant, the predominant character of the transaction. However, to address certain aspects of these scenarios, a new example at § 1.861–18(h)(24) (Example 24) of the final regulations describes the purchase of a video game for a one-time fee that has online and offline functionality, and that does not require paying a periodic subscription fee that is specific to that game to access the online content. Additionally, a new example at § 1.861–19(d)(11) (Example 11) of the final regulations describes the purchase of a video game for a one-time fee whose primary functionality is online and requires paying a monthly fee to the game developer to access the online content specific to the game. The examples conclude in both cases that, under the facts presented, a customer's purchase of a game has the predominant character of a sale of a copyrighted article. Neither example introduces additional complexity by describing a separate subscription fee that the customer must pay to a console maker to enable the online functionality of the console for all games played on that console. The Treasury Department and the IRS have concluded that such a fee would not be relevant to determining the character of transactions specific to the game itself under the final regulations. Such a fee is more akin to the monthly amount that a customer may pay to an internet service provider for internet access to play games online in general, because the fee is not specific to the game and is instead required to enable online functionality on a device that has other functions.

One comment recommended changes to the facts in § 1.861–18(h)(19) through (21) (Examples 19 through 21) of the proposed regulations, which contained a restriction on the transfer of the digital content by limiting the number of devices onto which the customer could download the content. Specifically, the comment recommended modernizing these examples by replacing the ''limited number of devices'' restriction with more general background that explains that the user agreement and the conditions and features of the provider's website and applications adequately restrict the end-user's ability to lend or otherwise transfer the digital content. In § 1.861–18(h)(19) and (21) (Examples 19 and 21) of the final regulations, the restriction on the number of devices is removed, and facts were added to make clear that no copyright rights were granted. Proposed § 1.861–18(h)(20) (Example 20), which discussed a business that offered end-users membership to a catalog of copyrighted music and required the end-users to download the songs, was removed from the final regulations because the Treasury Department and the IRS determined the facts described in the example were unrealistic.

III. Cloud Transactions

A. Classification of Cloud Transactions

Proposed § 1.861–19(c)(1) would provide that a cloud transaction is classified solely as either a lease of property or the provision of services, based on all relevant factors. Proposed § 1.861–19(c)(2) would enumerate a non-exhaustive list of potentially relevant factors, most of which come from section 7701(e) of the Code. The preamble to the proposed regulations requested comments as to whether the classification as either a lease or a service was correct, or whether cloud transactions are more properly classified in another category of income. The preamble also requested comments on realistic examples of cloud transactions that would be treated as leases under proposed § 1.861–19.

Several comments recommended that all cloud transactions be classified as services because the commentators could not identify any realistic cloud transaction that could be classified as a lease. One comment requested that the final regulations include an example of a cloud transaction that would be treated as a lease, but did not suggest a scenario in which a cloud transaction would be a lease. Alternatively, the comments recommended that the final regulations include a rebuttable presumption that all cloud transactions are classified as services.

In the absence of a rule stating all cloud transactions are services, several comments expressed concerns with, and suggested modifications to, certain factors listed in proposed § 1.861–19(c)(2). For example, some comments suggested that certain factors were not relevant for cloud transactions, or would generally weigh towards a lease characterization, but that overall, a cloud transaction should still be classified as the provision of services. Comments also recommended clarifying the treatment as services of related party data hosting transactions that involve cost-plus payments from a company under common control with the hosting company.

One comment suggested adding an example that commonly exists in practice that is similar to proposed § 1.861–19(d)(2) (Example 2), involving the provision of designated servers to

the customer, but with a shifted focus to analyze the access that a remote user may have to data and software on those servers.

Two comments expressed concerns that the proposed regulations may be used to characterize transactions of infrastructure providers, such as real estate investment trusts, who lease and otherwise make available real property and other infrastructure to cloud providers and similar tenants. These comments were concerned that the proposed regulations referenced the section 7701(e) factors to determine whether a cloud transaction was a service or a lease, and that these interpretations could affect the interpretation of the section 7701(e) factors in the context of non-cloud transactions.

The final regulations treat all cloud transactions solely as the provision of services and remove the section 7701(e) and other factors listed in the proposed regulations. Like the comments, the Treasury Department and the IRS could not identify a transaction that satisfies the definition of a cloud transaction that would be properly classified as a lease. Further, the Treasury Department and the IRS would expect future business models that meet the definition of a cloud transaction to constitute services rather than leases or other types of transactions. The services classification is appropriate because in a typical business model that includes a cloud transaction, the cloud provider retains economic control and possession over the relevant property (such as servers, software, or digital content, depending on the transaction) and the cloud transaction meets other hallmarks of a service transaction such as the provider having the ability to determine the specific property used to provide the cloud transaction and to replace such property with similar property. Note, however, that business models may include transactions involving computer hardware, such as a server, that is located at the customer's premises, and such a transaction may fall outside the definition of a cloud transaction (for example, because there is no on-demand network access provided in that transaction) and would therefore be classified under section 7701(e) and general tax principles. The Treasury Department and the IRS have also concluded that a more definite rule for characterization based on the definition of a cloud transaction will allow for better compliance and tax administration than the factors test in the proposed regulations. Because the final regulations classify all cloud transactions as the provision of services, examples applying the factors from the proposed regulations to determine whether a cloud transaction is a service or a lease have been removed (and no example concluding that the cloud transaction is a lease has been added).

Finally, one comment recommended expanding the characterization of cloud transactions to include licenses for transactions in which non-de minimis copyright rights are transferred. The comment described an example where an owner of digital content (a movie) streams that digital content to a movie theater and grants the movie theater the right to show the streamed content to customers. The comment concluded that the transaction between the content owner and the movie theater is a license. The comment expressed the belief that the manner in which digital content and accompanying public display or performance rights are delivered should not alone change the character of a transaction from a license to a service or lease.

The final regulations do not adopt this comment. In the scenario posited by the comment, the movie theater would be much more likely to download or otherwise obtain a copy of the movie than to stream the movie simultaneously with displaying the movie to customers, given the possibility of buffering or other technology issues that might occur while streaming and negatively impact the movie theater's customers. However, a somewhat similar scenario could occur if a bar or similar establishment streams music, sporting events, or other content as entertainment for customers eating or drinking at the establishment. While the agreement with the streaming service may grant the bar the right to perform or to display the streamed content to its customers, if there is no transfer of digital content (that is, no option to download of digital content), the transaction falls outside the digital content rules in § 1.861–18 and may be properly characterized as a cloud transaction. Whether there is a transfer of a copyright right that is not described in § 1.861–18(c)(2) would depend on copyright law. As described in Part I.B of this Summary of Comments and Explanation of Revisions, a fundamental requirement for a digital content transaction such as a license of copyright rights, as opposed to a cloud transaction involving digital content, is that the former involves a transfer of the digital content to the customer. If, however, the theater or the bar has the choice to download or stream the content, then § 1.861–18, including the predominant character rule, would apply to the transaction.

B. Inclusion of Common Cloud Business Models

One comment suggested that the final regulations explicitly include as cloud transactions certain common cloud-based business models, namely: (1) advertising models where customers obtain ''free'' services and advertisers pay for access to those customers; (2) marketplace sites and apps that function as sales agents; (3) gig-economy sites and apps that put service providers and customers together; (4) job recruiting sites and apps that find candidates for employers; (5) travel sites and apps that act like sales agents for hotels, flights, etc.; and (6) game sites that allow users access to a range of games for a subscription price.

The final regulations do not adopt this comment, though some similar examples are included in § 1.861–18(h). Although each of the comment's suggested scenarios include services or goods accessed through the internet, whether each scenario is a cloud transaction (as defined by § 1.861–19(b)) is fact-specific and cannot be determined solely on the basis of the type of offering provided. Section 1.861–19(b) defines a cloud transaction as a transaction through which a person obtains on-demand network access to computer hardware, digital content (as defined in § 1.861–18(a)(2)), or other similar resources. The first scenario, involving customers' ''free'' access to content that is funded by advertising, is similar to § 1.861–18(h)(22) (Example 22) of the final regulations. The example addresses the transfer of content to the platform by content creators (a digital content transaction) and the access to the content by customers (a cloud transaction). However, the example does not address the transaction between the advertisers and the platform because while the ads are viewable online, the advertising services are likely not cloud transactions because there is likely no on-demand network access to computer hardware, digital content, or similar resources provided by the platform to the advertisers (though specific fact patterns may differ). The second scenario, involving marketplace sites and apps that function as sales agents, may result in a transaction that has a digital content transaction element and a cloud transaction element if the marketplace site or app is used to transfer digital content to customers. *See* § 1.861–18(h)(20) (Example 20). Similarly, the sixth scenario, involving game sites allowing access to a range of games for a subscription price, may require a predominant character analysis to determine whether the

primary benefit to the customer (or a typical customer) is the download of games or access to play the games online. *See* § 1.861–18(h)(24) (Example 24). In the remaining scenarios proposed by the comment, the website or app may provide a service, but it is likely that the service would not be a cloud transaction because the recipient of the service does not receive on-demand network access to computer hardware, digital content, or similar resources. The framework of the final regulations should be applied to the facts of each specific transaction rather than making generalizations about broad categories of content offerings.

C. Examples Illustrating § 1.861–19

Many comments requested modifications to the examples provided in proposed § 1.861–19, or new examples describing common business models. In response to these comments, the final regulations contain several new examples and make certain modifications to the pre-existing examples. The final regulations also remove examples illustrating the proposed regulations' application of factors to distinguish between the characterization of a cloud transaction as a service or a lease because the final regulations characterize all cloud transactions as services.

Proposed § 1.861–19(d)(11) (Example 11) would describe a scenario in which a taxpayer operates an online database of industry-specific materials that utilizes a proprietary search engine. Certain materials in the database constitute digital content. The example concluded that the taxpayer's provision of on-demand access to its computer hardware and software is a cloud transaction. One comment requested clarification that the characterization of this transaction would not be different if the online database contained no copyrightable materials. In the final regulations, the analysis of this example (which has been redesignated § 1.861–19(d)(8) (Example 8)) explains that the cloud transaction is access to the search engine and online database, rather than online access to the digital content, and therefore the conclusion that the transaction is a cloud transaction would not change if none of the content in the database was copyrightable. This conclusion is consistent with § 1.861–19(b)'s definition of a cloud transaction as a transaction through which a person obtains on-demand network access to computer hardware, digital content (as defined in § 1.861–18(a)(2)), or other similar resources. In this case, the content accessed would be an ''other similar resource.''

Two comments expressed concern that certain jurisdictions around the world treat income earned by a reseller of services, such as software-as-a-service, as royalties subject to withholding. These comments asked for an example in the final regulations addressing a reseller of services that concludes the reseller's income is services income. In response to these comments, section 1.861–19(d)(10) (Example 10) of the final regulations addresses a reseller of software-as-a-service and concludes the transaction between the reseller and its customers is a cloud transaction classified as the provision of services.

Proposed § 1.861–19(d)(9) (Example 9) would describe a scenario in which a taxpayer maintains a catalogue of videos and music that it streams to customers in exchange for a monthly fee. To better reflect current and developing business practices, comments recommended adding a fact to this example that customers have the ability to download the digital content for offline viewing, and that such ability is de minimis in the context of the overall transaction. Proposed § 1.861–19(d)(9) (Example 9) is redesignated § 1.861–19(d)(7) (Example 7) of the final regulations, and the ability to download the digital content has been added to the facts in the example. As discussed in Part I.A of this Summary of Comments and Explanation of Revisions, a predominant character rule in the final regulations replaced the de minimis rule in the proposed regulations. Under the facts described in Example 7 of the final regulations, the predominant character of the transaction is a cloud transaction.

IV. Sourcing Rules

A. Source Rule for Sales of Copyrighted Articles Transferred Through an Electronic Medium

1. In General

Section 1.861–18(f)(2), as in effect before this Treasury decision, provided that income from sales of copyrighted articles is sourced under sections 861(a)(6), 862(a)(6), 863, 865(a), (b), (c), or (e), as appropriate. Proposed § 1.861–18(f)(2)(ii) would provide that when a copyrighted article is sold and transferred through an electronic medium, the sale is deemed to have occurred at the location of download or installation onto the end-user's device used to access the digital content for purposes of § 1.861–7(c). If information about the location of download or installation was not available, proposed § 1.861–18(f)(2)(ii) would provide that the sale is deemed to have occurred at the location of the customer, as determined based on the taxpayer's recorded sales data for business or financial reporting purposes.

Comments observed practical challenges with applying a rule based on the location of download or installation, including that: (i) data privacy laws may prevent taxpayers from collecting or retaining this information, (ii) internet Protocol (IP) addresses may be unreliable because virtual private networks may obscure an end-user's IP address, (iii) it would be burdensome and expensive for taxpayers to collect new data on the location of download or installation, (iv) there may be difficulties in determining the location of download or installation onto an end-user's device when software is sold through multi-level distribution channels, and (v) it may be difficult to identify the end-user. One comment suggested that the final regulations provide examples that illustrate the application of the download test in various circumstances.

Instead of endorsing the proposed rule, most comments addressing this topic recommended a rule that uses the billing address of the first unrelated purchaser to determine the location of the sale. Some comments observed that the billing address of the purchaser is information sellers already collect and is a more reliable indicator of where the purchaser will use the digital content. Several comments suggested that taxpayers be permitted to elect to use the location of download or installation instead of the billing address of the purchaser if the taxpayer has access to that information. Some comments recommended permitting taxpayers to elect to use the location of actual use of the digital content, such as when an employer purchases digital content that is used by an employee not located in the same jurisdiction as the employer.

Finally, another comment recommended that the rule in § 1.861–7(c) (which provides that the place of sale is the place where the rights, title, and interest of the seller in the property are transferred to the buyer (the title passage rule)) should be retained for purposes of sourcing sales of copyrighted articles transferred through an electronic medium.

The final regulations adopt these comments in part. Consistent with the proposed regulations, § 1.861–18(f)(2)(ii) of the final regulations moves away from the ''title passage'' rule for sales of copyrighted articles transferred through an electronic medium. One reason for the change is that the title passage rule allowed taxpayers to artificially elect the source of income from sales of copyrighted articles through an

electronic medium using contractual terms that had no real-world impact due to the nature of digital content. A digital download is an almost instantaneous transfer that occurs with limited risk of loss; even when a file is corrupted in the download or installation process, a noncorrupted copy can be provided to the customer at virtually no cost to the seller, and the precise location of the corruption is typically not relevant. In contrast, a contractual agreement as to when and where title passes for physical property moved through physical distribution chains has real-world impact because the property may be lost or become damaged in transit and the location of title passage determines whether the seller or buyer bears the burden of that loss. Because the nature of the supply chain means that the seller retains risk of loss until a successful download, § 1.861–18(f)(2)(ii) treats the sale as having occurred at the customer's location, using the customer's billing address as a proxy. The Treasury Department and IRS generally agree that a billing address is more administrable than the location of download or installation as a suitable proxy for the place of sale of electronically transferred copyrighted articles (subject to the anti-abuse rule discussed below).

The Treasury Department and IRS disagree, however, that the billing address of a subsequent unrelated purchaser of the same copyrighted article should be the general rule for sales between related parties, given the focus of the statutory sourcing provisions on place of sale. *See* sections 861 through 865. It would also be complex and potentially inaccurate to attempt to determine whether every sale is intended for a related or unrelated purchaser. Therefore, § 1.861–18(f)(2)(ii) of the final regulations provides that when a copyrighted article is sold and transferred through an electronic medium, the sale is deemed to have occurred at the location of the billing address of the purchaser for purposes of § 1.861–7(c), regardless of whether that purchaser is a related or unrelated party. This billing address rule also resolves the issue raised by comments regarding who the end-user is in certain transactions because the sourcing rule is based on the immediate purchaser in the transaction. *See* § 1.861–18(h)(25) (Example 25).

The final regulations also do not provide for an election to treat the sale of a copyrighted article as occurring at the location of download or installation. As noted earlier in this part, one of the reasons for moving away from ''title passage'' for sales of copyrighted articles transferred through an electronic medium was that it allowed sellers the ability to artificially elect the source of the income. Consistent with this concern about electivity, the final regulations provide a single, administrable rule that applies to all sales (subject to the anti-abuse rule).

The final regulations also add a new anti-abuse rule for any case in which the sales transaction is arranged in a particular manner for a principal purpose of tax avoidance. *See* § 1.861–18(f)(2)(ii) and (h)(26) (Example 26). In such cases, the foregoing billing address rule will not be applied, and instead all relevant facts and circumstances of the transaction will be considered to treat the sale as having occurred where the substance of the transaction occurred. This anti-abuse rule replaces the anti-abuse rule in § 1.861–7(c) with respect to sales of copyrighted articles sold and transferred through an electronic medium.

Finally, several comments asked for clarification that this source rule applies solely for purposes of the title passage rule of § 1.861–7(c). The Treasury Department and the IRS have concluded that these comments were already addressed in proposed § 1.861–18(f)(2)(ii) by the language that limited application of the rule ''for purposes of § 1.861–7(c),'' and the final regulations retain this language.

2. Coordination With Section 863(b)

Some comments recommended allowing taxpayers to elect to apply a billing address source rule for sales of digital content where section 863(b) may otherwise apply. Section 863(b) provides, in part, that the gains, profits, and income from the sale or exchange of inventory property produced (in whole or in part) by the taxpayer within the United States and sold or exchanged without the United States, or produced (in whole or in part) by the taxpayer without the United States and sold or exchanged within the United States, shall be allocated and apportioned between sources within and without the United States solely on the basis of the production activities with respect to the property.

The final regulations do not adopt the comment recommending allowing taxpayers to elect to apply a billing address source rule for sales of digital content where section 863(b) would apply. When section 863(b) applies, property produced and sold by a taxpayer must be sourced ''solely on the basis of the production activities with respect to the property.'' There is nothing to suggest that the billing address of the customer is relevant to this statutory rule based on place of production, and so the final regulations do not adopt this comment.

3. Interaction With Rules for Sourcing Leases and Licenses of Digital Content

One comment supported the location of download or installation rule for determining the place of sale for copyrighted articles, and recommended the final regulations explicitly adopt a uniform rule for sourcing income from sales, leases, and licenses of digital content based on the location of the end-user. The comment also recommended allowing taxpayers to rely on recorded sales data to determine the location of the end-user for purposes of determining place of use for leases and licenses of digital content.

The final regulations do not adopt this comment. Section 1.861–18(f)(2)(ii) clarifies how the place of sale of digital content is determined for purposes of sections 861 through 865. Those sections contain different rules for determining the source of income from leases and licenses, for which the place of transfer is not the relevant statutory rule (generally, the determination is based on where the property subject to the lease or license is used, or where the possessor of the interest has the right to use the property). *See* sections 861(a)(4), 862(a)(4). Section 1.861–18(f)(2)(ii) looks to the customer's billing address for purposes of determining the place of sale for purposes of § 1.861–7(c). While that may sometimes also be the location in which the digital content is used, that is not necessarily the case. For example, where copyright rights are transferred in a transaction that is classified as a license, the copyright rights may be used in multiple locations, and not just the location of the customer's billing address. Similarly, not all income from sales is sourced to the place where the sale occurred. In those cases, the statute provides the relevant determination, such as the place of production in section 863(b) or the residence of the seller in section 865(a). The location of download or installation is not necessarily indicative of any of those things, and the Treasury Department and the IRS only intend for the rule in § 1.861–18(f)(2)(ii) to be used to determine the place where the sale occurred for purposes of statutory sourcing rules that rely on that determination. Therefore, § 1.861–18(f)(2)(ii) of the final regulations is not extended to provide a sourcing rule for all sales, licenses, and leases of digital content.

Finally, a comment suggested that the regulations clarify that a license of copyright rights from a copyright owner

to a distributor is sourced under section 861(a)(4) or 862(a)(4). Because § 1.861–18(f)(2), as in effect before this Treasury decision, already provides that income derived from licensing copyright rights is sourced under section 861(a)(4) or 862(a)(4), no changes have been made in response to this comment.

B. Source Rule for Gross Income From a Cloud Transaction

Proposed § 1.861–19 would not provide a source rule for cloud transactions. As such, the proposed regulations indicated that existing law, regulations, and IRS guidance regarding sourcing services and leases would apply to sourcing cloud transactions. Numerous comments were received regarding whether a specific source rule for cloud transactions would be appropriate and several of these comments included suggestions for such a rule.

The Treasury Department and the IRS are of the view that that there would be benefits for taxpayer compliance and administrability if gross income from cloud transactions were sourced using a uniform rule. Thus, the Treasury Department and the IRS are issuing proposed regulations (REG–107420–24) published elsewhere in this same issue of the **Federal Register** that provide rules for determining the source of gross income from a cloud transaction.

C. Removal of Example 5 From § 1.937–3(e)

The proposed regulations would have removed Examples 4 and 5 from § 1.937–3(e). Section 937 provides residence and source rules involving territories. Examples 4 and 5 of § 1.937–3(e) relate to the sourcing of income from digital content transactions and cloud transactions, respectively. One comment suggested that the proposal to remove Example 5 was premature because the proposed regulations did not include a source rule for cloud transactions. The final regulations do not accept this comment. As discussed in Part IV.B of this Summary of Comments and Explanation of Revisions, the Treasury Department and the IRS are issuing a companion notice of proposed rulemaking addressing the source of income from cloud transactions concurrent with these final regulations. Therefore, to avoid potentially inconsistent inferences, the final regulations remove both Examples 4 and 5 of § 1.937–3(e).

V. Comments Outside the Scope of This Treasury Decision

The preamble to Treasury Decision 8785, which promulgated § 1.861–18 in 1998, stated that the Treasury Department and the IRS were considering whether to issue guidance regarding whether transactions in copyrighted articles are transactions in tangible property, and whether transactions in copyright rights are transactions in intangible property, in each case for purposes of section 482. The proposed regulations did not contain further guidance on this topic.

One comment to the proposed regulations recommended that the Treasury Department and the IRS reconsider this matter and issue guidance on this topic because the characterization of a transfer of digital content as tangible or intangible property is important for purposes of sections 250, 367(d), and 482. The Treasury Department and IRS have determined that guidance on whether the categories of transactions in § 1.861–18 are considered tangible or intangible property for purposes of such Code sections is outside the scope of these regulations.

One comment suggested that section 904 should be amended as it relates to certain sales income earned by U.S. residents to prevent ''cross-crediting'' of high-taxed income and zero- or low-taxed income within the same foreign tax credit basket under section 904(d)(1). The comment noted that such ''cross-crediting'' results in the U.S. partially or fully bearing the cost of the high tax rates in some foreign jurisdictions because a credit related to the high-taxed income may offset U.S. tax on the income from low-tax jurisdictions. Amendments to section 904 are outside the scope of this Treasury Decision.

Two comments suggested changes to the regulations under section 250 pertaining to foreign-derived intangible income (FDII). One comment requested that the Treasury Department and the IRS introduce a rule under § 1.250(b)–4 stating that intangible property used in providing a service that is a cloud transaction within the meaning of § 1.861–19 is, for purposes of section 250, used at the location of the employees engaged in, and tangible property used in, providing the cloud transaction service. That comment also suggested adding a de minimis rule under § 1.250(b)–4 providing that any de minimis use of intangible property is disregarded in a cloud transaction. A second comment noted that the characterization of a cloud transaction would impact whether income is eligible for the FDII deduction because there are different rules for establishing ''foreign use'' for services and lease transactions. That comment also suggested that the ''foreign use'' rule for intangible property should replicate the rule governing foreign use of general property. These comments are outside the scope of this Treasury Decision, but were considered in finalizing the section 250 regulations. *See* T.D. 9901 (85 FR 43042, July 15, 2020).

VI. Final Regulations Apply Only for Certain International Provisions of the Code

Section 1.861–18, as in effect before this Treasury decision, applied only to certain listed international provisions of the Code. When § 1.861–18 was promulgated in 1998, the preamble stated that the Treasury Department and the IRS were considering whether the principles of § 1.861–18 should apply to other provisions of the Code. The proposed regulations retained the scope of § 1.861–18 by applying only to certain listed international provisions of the Code, although additional sections of the Code were added to the scope of the proposed regulations due to changes in law between 1998 and the date of the proposed regulations. Proposed § 1.861–19 would also apply only to the same listed international provisions of the Code.

The Treasury Department and the IRS received comments recommending expanding the scope of the final regulations to apply for all purposes of the Code, particularly with respect to § 1.861–18 for which all comments received on this topic recommended expansion to all purposes of the Code. Multiple comments expressed that the framework of the proposed regulations provides sensible rules and certainty with respect to transactions involving digital content. One comment also expressed concern that limiting the scope of the final regulations to only international provisions of the Code could lead to the same transaction being characterized differently depending on which Code section was applied. Another comment expressed the belief that both taxpayers and the IRS will utilize the guidance in the final regulations by analogy even if the final regulations apply only to international provisions of the Code, and that it would be better to make it clear that the final regulations apply to all provisions of the Code so that taxpayers and the IRS will not have to go through the rigors of trying to convince the other party that the final regulations are relevant in a particular case.

Unlike § 1.861–18, some comments recommended that § 1.861–19 not be applied beyond the scope provided in the proposed regulations. These comments expressed concern that the

preamble to § 1.861–19 referenced section 7701(e) (pertaining to the treatment of certain contracts as leases rather than service contracts), and recommended against any guidance providing that section 7701(e) could apply throughout the Code, including Subchapter M. One comment explained that the extent to which the provision of services affects the definition of ''rents from real property'' for real estate investment trust purposes is addressed not only in Subchapter M and the regulations thereunder, but also in numerous items of IRS sub-regulatory guidance and private letter rulings specifically interpreting Subchapter M. The comments recommended adding an explicit disclaimer in the preamble and the text of the final regulations that any purported interpretation and application of section 7701(e) principles in the final regulations do not apply outside the intended scope of the final regulations, and therefore do not apply to lease-versus-service determinations under other provisions of chapter 1 of the Code. As discussed under Part III.A of this Summary of Comments and Explanation of Revisions, the final regulations treat all cloud transactions as the provision of services, and accordingly remove the section 7701(e) factors from the regulatory text.

More broadly, the Treasury Department and the IRS continue to study issues related to applying the final regulations to all provisions of the Code. Concurrently with the issuance of the final regulations, the Treasury Department and the IRS are issuing a Notice (Notice 2025–6) requesting comments regarding issues to consider in deciding whether to apply the characterization rules in §§ 1.861–18 and 1.861–19, as amended and added, respectively, by the final regulations to all provisions of the Code.

VII. Change in Method of Accounting

The proposed regulations would treat a change in method of accounting that a taxpayer made in order to comply with the proposed regulations as a change initiated by the taxpayer. Accordingly, the change in method of accounting would have to be implemented under the rules of § 1.446–1(e) and the applicable administrative procedures that govern voluntary changes in method of accounting under section 446(e).

Two comments suggested that if a taxpayer must change its method of accounting in order to comply with the final regulations, then such change should be eligible for automatic consent.

The final regulations do not adopt these comments. The Treasury Department and the IRS generally do not anticipate taxpayers needing to change methods of accounting as a result of the final regulations. Additionally, in light of the aforementioned Notice requesting comments on applying the characterization rules in §§ 1.861–18 and 1.861–19, as amended and added, respectively, by the final regulations for all purposes of the Code, the Treasury Department and IRS have determined that it is important to ensure that any accounting method changes due to these regulations are consistent with the appropriate treatment of the transactions at issue under all appropriate Code or regulation sections.

VIII. Applicability Date

The proposed regulations were proposed to apply to transactions entered into pursuant to contracts entered into in taxable years beginning on or after the date of publication of final regulations.

Comments recommended the final regulations apply to transactions entered into in taxable years beginning on or after the date that final regulations are published, regardless of the date of the contracts pursuant to which such transactions were entered into. One comment noted that it would be difficult to trace particular transactions to contracts that were entered into in taxable years that begin on or after the date of publication of final regulations. Other comments noted that the proposed applicability date may result in different rules applying to similar transactions of the same taxpayer long after these regulations are finalized.

One comment suggested allowing taxpayers to elect application of the final regulations to taxable years ending after the date of publication of the proposed regulations. Another comment recommended that taxpayers be allowed to elect to apply the final regulations to transactions taking place before the effective date of the final regulations.

In response to these comments, the final regulations generally apply to taxable years beginning on or after the date of publication of this Treasury decision in the **Federal Register**. However, taxpayers may elect to apply all of the rules of the final regulations to taxable years beginning on or after August 14, 2019 and all subsequent taxable years as long as all related persons (within the meaning of sections 267(b) and 707(b)) also apply all of the rules of the final regulations to taxable years beginning on or after August 14, 2019 and all subsequent taxable years, the period of limitations on assessment for each taxable year of the taxpayer and all related parties (within the meaning of sections 267(b) and 707(b)) is open under section 6501, and the taxpayer would not be required under this section to change its method of accounting as a result of such election.

Special Analyses

I. Regulatory Planning and Review—Economic Analysis

Pursuant to the Memorandum of Agreement, Review of Treasury Regulations under Executive Order 12866 (June 9, 2023), tax regulatory actions issued by the IRS are not subject to the requirements of section 6 of Executive Order 12866, as amended. Therefore, a regulatory impact assessment is not required.

II. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) (PRA) generally requires that a Federal agency obtain the approval of the Office of Management and Budget (OMB) before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

The collections of information in these final regulations contain reporting and recordkeeping requirements that are necessary to ensure the correct classification of digital content transactions and cloud transactions. The collections will be used by the IRS for tax compliance purposes.

The final regulation mentions a reporting requirement where a taxpayer may be required to change its method of accounting. For PRA purposes, Form 3115, Application for Change in Accounting Method, is already approved by OMB under Control Numbers 1545–0047 for tax-exempt entities, 1545–0074 for individuals, 1545–0123 for business filers and 1545–0092 for trust and estate filers.

The recordkeeping requirements include that entities keep records of their transactions to substantiate the transaction classification. These recordkeeping requirements are considered general tax records under § 1.6001–1(e). For PRA purposes, general tax records are already approved by OMB under 1545–0047 for tax-exempt entities, 1545–0074 for individuals, 1545–0123 for business filers and 1545–0092 for trust and estate filers.

These final regulations are not creating new information collections or changing information collections already approved by OMB.

III. Regulatory Flexibility Act

The Regulatory Flexibility Act requires consideration of the regulatory impact on small businesses. It is hereby certified that these final regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6).

Although data are not readily available to estimate the number of small entities that would be affected by the final regulations, the Treasury Department and the IRS project that any economic impact of the regulations would be minimal for businesses regardless of size. These final regulations generally provide clarification of definitions regarding how transactions are classified, and thus are not expected to have an impact on burden for large or small businesses. The Treasury Department and the IRS project that any economic impact would be small because current industry practice is generally consistent with the principles underlying the final regulations.

IV. Section 7805(f)

Pursuant to section 7805(f) of the Code, the proposed regulations (REG–130700–14) preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact on small businesses and no comments were received.

V. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. The final regulations do not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

VI. Executive Order 13132: Federalism

Executive Order 13132 (entitled ''Federalism'') prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statutes, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. The final regulations do not have federalism implications, do not impose substantial direct compliance costs on State and local governments, and do not preempt State law within the meaning of the Executive order.

Drafting Information

The principal authors of these final regulations are Christopher E. Fulle and Michelle L. Ng of the Office of the Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, the Treasury Department and the IRS amend 26 CFR part 1 as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.**The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

■ **Par. 2.** Section 1.861–7 is amended by revising paragraph (c) to read as follows:

§ 1.861–7 Sale of personal property.

* * * * *

(c) *Country in which sold.* For purposes of part I (section 861 and following), subchapter N, chapter 1 of the Code, and the regulations thereunder, a sale of personal property is consummated at the time when, and the place where, the rights, title, and interest of the seller in the property are transferred to the buyer. Where bare legal title is retained by the seller, the sale shall be deemed to have occurred at the time and place of passage to the buyer of beneficial ownership and the risk of loss. However, in any case in which the sales transaction is arranged in a particular manner for the primary purpose of tax avoidance, the foregoing rules will not be applied. In such cases, all factors of the transaction, such as negotiations, the execution of the agreement, the location of the property, and the place of payment, will be considered, and the sale will be treated as having been consummated at the place where the substance of the sale occurred. For determining the place of sale of copyrighted articles transferred through an electronic medium, see § 1.861–18(f)(2)(ii).

* * * * *

■ **Par. 3.** Section 1.861–18 is amended by:

■ a. Revising the section heading;

■ b. Revising paragraphs (a), (b), (c)(1), (c)(2)(i) through (iv), (c)(3), (d), (e), (f)(1) through (3), (g)(2), (g)(3)(i) and (ii), and (h) through (j); and

■ c. Removing paragraph (k).

The revisions read as follows:

§ 1.861–18 Classification of, and source of gross income from, digital content transactions.

(a) *General*—(1) *Scope.* This section provides rules for classifying digital content transactions (as defined in paragraph (b)(1) of this section) for purposes of subchapter N of chapter 1 of the Internal Revenue Code, sections 59A, 245A, 250, 267A, 367, 404A, 482, 679, 1059A, chapters 3 and 4, sections 842 and 845 (to the extent involving a foreign person), and transfers to foreign trusts not covered by section 679.

(2) *Digital content*—(i) *Digital content defined.* For purposes of this section, digital content means a computer program or any other content, such as books, movies, and music, in digital format that is—

(A) Protected by copyright law; or

(B) Not protected by copyright law solely—

(*1*) Due to the passage of time; or

(*2*) Because the creator dedicated the content to the public domain.

(ii) *Computer program defined.* For purposes of this section, a computer program is a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result and includes any media, user manuals, documentation, data base, or similar item if the media, user manuals, documentation, data base, or other similar item is incidental to the operation of the computer program.

(b) *Categories of transactions*—(1) *General.* A transaction that constitutes a transfer of digital content, or the provision of services or of know-how with respect to digital content (each a digital content transaction), is treated as being solely one of the following—

(i) A transfer of a copyright right in the digital content;

(ii) A transfer of a copy of the digital content (a copyrighted article);

(iii) The provision of services for the development or modification of the digital content; or

(iv) The provision of know-how relating to development of digital content.

(2) *Transaction with multiple elements.* Taking into account the

overall transaction and the surrounding facts and circumstances, a transaction that has multiple elements, one or more of which would be a digital content transaction if considered separately, is classified in its entirety as a digital content transaction under one of the categories described in paragraph (b)(1) of this section if the predominant character of the transaction is described in one of the categories in that paragraph.

(3) *Determination of predominant character*—(i) *General rule.* For purposes of paragraph (b)(2) of this section and § 1.861–19(c)(2), the predominant character of a transaction is determined by ascertaining the primary benefit or value received by the customer in the transaction.

(ii) *Special rule.* If the primary benefit or value received by the customer in the transaction is not reasonably ascertainable, the predominant character of a transaction is instead determined by ascertaining the primary benefit or value received by a typical customer in a substantially similar transaction as determined under paragraphs (b)(3)(ii)(A) and (B) of this section.

(A) The primary benefit or value received by a typical customer is determined by data on how a typical customer uses or accesses the digital content. See paragraph (h)(17) of this section (*Example 17*).

(B) If data described in paragraph (b)(3)(ii)(A) of this section is not available, then the predominant character of a transaction subject to the special rule in paragraph (b)(3)(ii) of this section is determined by examining other factors that are indicative of the primary benefit or value received by a typical customer, including the following—

(*1*) How the transferor or provider markets the transaction;

(*2*) The relative development costs to the transferor or provider of each element of the transaction; and

(*3*) The relative price paid in an uncontrolled transaction for one or more elements compared to the total contract price of the transaction in question.

(iii) *Identification and development of data.* A transferor or provider must use reasonable efforts to identify the data specified in paragraphs (b)(3)(i) and (ii)(A) of this section, or if necessary, to apply the factors relevant to paragraph (b)(3)(ii)(B) of this section. However, a transferor or provider is not required to develop any of the data specified in those paragraphs that it does not develop in the course of business.

(c) * * *

(1) *Transfers involving transfers of copyright rights.* A digital content transaction involves a transfer of a copyright right if, as a result of the transaction, a person acquires one or more of the rights described in paragraphs (c)(2)(i) through (iv) of this section.

(2) * * *

(i) The right to make copies of the digital content for purposes of distribution to the public by sale or other transfer of ownership, or by rental, lease or lending;

(ii) The right to prepare derivative digital content based upon the digital content;

(iii) The right to make a public performance of digital content, other than a right to publicly perform digital content for the purpose of advertising the sale of the digital content performed; or

(iv) The right to publicly display digital content, other than a right to publicly display digital content for the purpose of advertising the sale of the digital content displayed.

(3) *Copyrighted articles.* A copyrighted article includes a copy of digital content from which the work can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. The copy of the digital content may be fixed in any medium.

(d) *Provision of services.* The determination of whether a transaction involving newly developed or modified digital content involves the provision of services described in paragraph (b)(1) of this section is based on all the facts and circumstances of the transaction, including, as appropriate, the intent of the parties (as evidenced by their agreement and conduct) as to which party is to own the copyright rights in the digital content and how the risks of loss are allocated between the parties. See paragraph (h)(15) of this section (*Example 15*).

(e) *Provision of know-how.* The provision of information with respect to digital content involves the provision of know-how for purposes of this section only if the information is—

(1) Information relating to the development of digital content;

(2) Furnished under conditions preventing unauthorized disclosure, specifically contracted for between the parties; and

(3) Considered property subject to trade secret protection.

(f) * * *

(1) *Transfers of copyright rights.* The determination of whether a transfer of a copyright right is a sale or exchange of property is made on the basis of whether, taking into account all facts and circumstances, there has been a transfer of all substantial rights in the copyright. A transfer of a copyright right that does not constitute a sale or exchange because not all substantial rights have been transferred will be classified as a license. For this purpose, the principles of sections 1222 and 1235 apply. Income derived from the sale or exchange of a copyright right will be sourced under section 865(a), (c), (d), (e), or (h), as appropriate. Income derived from the licensing of a copyright right will be sourced under section 861(a)(4) or 862(a)(4), as appropriate.

(2) *Transfers of copyrighted articles*—(i) *Classification.* The determination of whether a transfer of a copyrighted article is a sale or exchange is made on the basis of whether, taking into account all facts and circumstances, the benefits and burdens of ownership have been transferred. A transfer of a copyrighted article that does not constitute a sale or exchange because insufficient benefits and burdens of ownership of the copyrighted article have been transferred, such that a person other than the transferee is properly treated as the owner of the copyrighted article, will be classified as a lease.

(ii) *Source.* Income from transactions that are classified as sales or exchanges of copyrighted articles will be sourced under section 861(a)(6), 862(a)(6), 863, or 865(a), (b), (c), or (e), as appropriate. When a copyrighted article is sold and transferred through an electronic medium, the sale is deemed to have occurred at the location of the billing address of the purchaser for purposes of § 1.861–7(c). However, in any case in which the sales transaction is arranged in a particular manner for a principal purpose of tax avoidance, the foregoing rules will not be applied. In such a case, all of the facts and circumstances relevant to the transaction, such as the place where the copyrighted article will be used, the place where negotiations and the execution of the agreement occurred, and the terms of the agreement, will be considered, and the sale will be treated as having occurred where the substance of the sale occurred. Income derived from leasing a copyrighted article will be sourced under section 861(a)(4) or 862(a)(4), as appropriate.

(3) *Special circumstances of digital content.* In connection with determinations under this paragraph (f), consideration must be given as appropriate to the special characteristics of digital content in transactions that take advantage of these characteristics (such as the ability to make perfect

copies at minimal cost). For example, a transaction in which a person acquires a copy of digital content on a disk subject to a requirement that the disk be destroyed after a specified period is generally the equivalent of a transaction subject to a requirement that the disk be returned after such period. Similarly, a transaction in which the digital content deactivates itself after a specified period is generally the equivalent of a transaction subject to a requirement that the disk be returned after a specified period.

(g) * * *

(2) *Means of transfer not to be taken into account.* The rules of this section shall be applied irrespective of the physical or electronic or other medium used to effectuate a digital content transaction.

(3) * * *

(i) *In general.* For purposes of paragraph (c)(2)(i) of this section, a transferee of digital content shall not be considered to have the right to distribute copies of the digital content to the public if it is permitted to distribute copies of the digital content to only either a related person, or to identified persons who may be identified by either name or by legal relationship to the original transferee. For purposes of this subparagraph, a related person is a person who bears a relationship to the transferee specified in section 267(b)(3), (10), (11), or (12), or section 707(b)(1)(B). In applying section 267(b), 267(f), 707(b)(1)(B), or 1563(a), ''10 percent'' shall be substituted for ''50 percent.''

(ii) *Use by individuals.* The number of employees of a transferee of digital content who are permitted to use the digital content in connection with their employment is not relevant for purposes of this paragraph (g)(3). In addition, the number of individuals with a contractual agreement to provide services to the transferee of digital content who are permitted to use the digital content in connection with the performance of those services is not relevant for purposes of this paragraph (g)(3).

(h) *Examples.* The examples in this paragraph (h) illustrate the provisions of this section. Unless otherwise specified, assume that Corp A is a domestic corporation, the digital content described in each example does not contain any online functionality, and all facts in each example occur as part of a single transaction.

(1) *Example 1: Sale of a computer program on a disk*—(i) *Facts.* Corp A owns the copyright in a computer program, Program X. It copies Program X onto disks. The disks are placed in boxes covered with a wrapper on which is printed what is generally referred to as a shrink-wrap license. The license is stated to be perpetual. Under the license no reverse engineering, decompilation, or disassembly of the computer program is permitted. The transferee receives, first, the right to use the program on two of its own computers (for example, a laptop and a desktop) provided that only one copy is in use at any one time, and second, the right to make one copy of the program on each machine as an essential step in the utilization of the program. The transferee is permitted by the shrink-wrap license to sell the copy so long as it destroys any other copies it has made and imposes the same terms and conditions of the license on the purchaser of its copy. These disks are made available for sale to the general public in Country Z. In return for valuable consideration, P, a Country Z resident, receives one such disk.

(ii) *Analysis.* (A) Under paragraph (b)(1) of this section, the transfer of a disk containing a copy of Program X from Corp A to P is a digital content transaction with one element, which is the transfer of a copy of Program X. Therefore, the transaction is treated solely as a transfer of a copyrighted article under paragraph (b)(1)(ii) of this section. Under paragraph (g)(1) of this section, the label license is not determinative.

(B) Taking into account all of the facts and circumstances, P is properly treated as the owner of a copyrighted article. Therefore, under paragraph (f)(2) of this section, there has been a sale of a copyrighted article rather than the grant of a lease.

(2) *Example 2: Sale of a computer program via download from the internet*—(i) *Facts.* The facts are the same as those in paragraph (h)(1) of this section (*Example 1*), except that instead of selling disks, Corp A decides to make Program X available, for a fee, on a World Wide Web home page on the internet. P, the Country Z resident, in return for payment made to Corp A, downloads Program X (via modem) onto the hard drive of his computer. As part of the electronic communication, P signifies his assent to a license agreement with terms identical to those in *Example 1,* except that in this case P may make a back-up copy of the program on to a disk.

(ii) *Analysis.* (A) Under paragraph (b)(1) of this section, the digital transfer of a copy of Program X from Corp A to P is a digital content transaction with one element, which is the transfer of a copy of Program X. Therefore, the transaction is treated solely as a transfer of a copyrighted article under paragraph (b)(1)(ii) of this section. Although P did not buy a physical copy of the disk with the program on it, paragraph (g)(2) of this section provides that the means of transferring the program is irrelevant.

(B) As in paragraph (h)(1) of this section (*Example 1*), P is properly treated as the owner of a copyrighted article. Therefore, under paragraph (f)(2) of this section, there has been a sale of a copyrighted article rather than the grant of a lease.

(3) *Example 3: Lease of a computer program with requirement to return disk*—(i) *Facts.* The facts are the same as those in paragraph (h)(1) of this section (*Example 1*), except that Corp A only allows P, the Country Z resident, to use Program X for one week. At the end of that week, P must return the disk with Program X on it to Corp A. P must also destroy any copies made of Program X. If P wishes to use Program X for a further period he must enter into a new agreement to use the program for an additional charge.

(ii) *Analysis.* (A) Under paragraph (b)(1) of this section, the transfer of a disk with a copy of Program X from Corp A to P is a digital content transaction with one element, which is the transfer of a copy of Program X. Therefore, the transaction is treated solely as a transfer of a copyrighted article under paragraph (b)(1)(ii) of this section.

(B) Taking into account all of the facts and circumstances, P is not properly treated as the owner of a copyrighted article. Therefore, under paragraph (f)(2) of this section, there has been a lease of a copyrighted article rather than a sale. Taking into account the special characteristics of digital content as provided in paragraph (f)(3) of this section, the result would be the same if P were required to destroy the disk at the end of the one-week period instead of returning it since Corp A can make additional copies of the program at minimal cost.

(4) *Example 4: Lease of a computer program with electronic lock*—(i) *Facts.* * * *

(ii) *Analysis.* (A) Under paragraph (b)(1) of this section, the digital transfer of a copy of Program X from Corp A to P is a digital content transaction with one element, which is the transfer of a copy of Program X. Therefore, the transaction is treated solely as a transfer of a copyrighted article under paragraph (b)(1)(ii) of this section.

(B) As in paragraph (h)(3) of this section (*Example 3*), P is not properly treated as the owner of a copyrighted article. Therefore, under paragraph (f)(2) of this section, there has been a lease of a copyrighted article rather than a sale.

While P does retain Program X on its computer at the end of the one-week period, as a legal matter P no longer has the right to use the program (without further payment) and, indeed, cannot use the program without the electronic key. Functionally, Program X is no longer on the hard drive of P's computer. Instead, the hard drive contains only a series of numbers which no longer perform the function of Program X. Although in *Example 3,* P was required to physically return the disk, taking into account the special characteristics of digital content as provided in paragraph (f)(3) of this section, the result in this paragraph (h)(4) (*Example 4*) is the same as in *Example 3.*

(5) *Example 5: Sale of copyright rights to a computer program*—(i) *Facts.* Corp A transfers a disk containing Program X to Corp B, a Country Z corporation, and grants Corp B an exclusive license for the remaining term of the copyright to copy and distribute an unlimited number of copies of Program X in the geographic area of Country Z, prepare derivative works based upon Program X, make public performances of Program X, and publicly display Program X. Corp B will pay Corp A a royalty of $y a year for three years, which is the expected period during which Program X will have commercially exploitable value (a period shorter than the copyright term). Corp A has ascertained that the primary benefit or value from the transaction to Corp B is derived from the four legal rights obtained in Program X from Corp A and not from the receipt of a copy of Program X. The transfer of a copy of Program X is merely the means by which Corp A provides Corp B access to Program X in order to exercise its copyright rights.

(ii) *Analysis.* (A) The transaction between Corp A and Corp B has multiple elements. One element is the transfer of a disk with a copy of Program X, which would be a digital content transaction described under paragraph (b)(1)(ii) of this section (transfer of a copyrighted article) if considered separately. Another element is the grant of the right to make an unlimited number of copies of Program X and distribute those copies to the public, the right to prepare derivative works based upon Program X, the right to make public performances of Program X, and the right to publicly display Program X, which would be described under paragraphs (b)(1)(i) and (c)(2) of this section (transfer of a copyright right) if considered separately.

(B) Because the transaction has multiple elements, one or more of which would be a digital content transaction if considered separately, paragraph (b)(2) of this section provides that the transaction is classified within a single category under paragraph (b)(1) of this section if its predominant character is described in that paragraph. Pursuant to paragraph (b)(3)(i) of this section, the predominant character of the transaction is based on the primary benefit or value of the transaction to the customer, if it is reasonably ascertainable. The predominant character of this transaction is therefore the transfer of copyright rights because the primary benefit or value received by Corp B from the transaction is the ability to exercise the copyright rights described in paragraph (c)(2) of this section. Therefore, this transaction is classified solely as a transfer of copyright rights described in paragraph (b)(1)(i) of this section.

(C) Applying the all substantial rights test under paragraph (f)(1) of this section, Corp A will be treated as having sold copyright rights to Corp B. Corp B has acquired all of the copyright rights in Program X, has received the right to use them exclusively within Country Z, and has received the rights for the remaining life of the copyright in Program X. The fact the payments cease before the copyright term expires is not controlling. Under paragraph (g)(1) of this section, the fact that the agreement is labelled a license is not controlling nor is the fact that Corp A receives a sum labelled a royalty. (The result in this case would be the same if the copy of Program X to be used for the purposes of reproduction were transmitted electronically to Corp B, as a result of the application of the rule of paragraph (g)(2) of this section.)

(6) *Example 6: License of copyright right to make copies of a computer program and distribute to the public*—(i) *Facts.* Corp A transfers a disk containing Program X to Corp B, a Country Z corporation, and grants Corp B the non-exclusive right to reproduce and distribute for sale to the public an unlimited number of disks containing Program X at its factory in Country Z in return for a payment related to the number of disks copied and sold. The term of the agreement is two years, which is less than the remaining life of the copyright. Corp A has ascertained that the primary benefit or value from the transaction to Corp B is derived from the right to reproduce and distribute Program X and not from the receipt of a copy of Program X. The transfer of a copy of Program X is merely the means by which Corp A provides Corp B access to Program X in order to exercise its copyright rights.

(ii) *Analysis.* (A) The transaction between Corp A and Corp B has multiple elements. One element is the transfer of a disk with a copy of Program X, which would be described under paragraph (b)(1)(ii) of this section (transfer of a copyrighted article) if considered separately. Another element is the grant of the right to reproduce and distribute for sale to the public an unlimited number of disks containing Program X, which would be described under paragraphs (b)(1)(i) and (c)(2)(i) of this section (transfer of a copyright right) if considered separately.

(B) Because the transaction has multiple elements, one or more of which would be a digital content transaction if considered separately, paragraph (b)(2) of this section provides that the transaction is classified within a single category under paragraph (b)(1) of this section if its predominant character is described in that paragraph. Pursuant to paragraph (b)(3) of this section, the predominant character of the transaction is based on the primary benefit or value of the transaction to the customer, if it is reasonably ascertainable. The predominant character of this transaction is therefore the transfer of a copyright right because the primary benefit or value received by Corp B is the right to reproduce and distribute for sale to the public copies of Program X. Therefore, this transaction is classified solely as a transfer of copyright rights described in paragraph (b)(1)(i) of this section.

(C) Taking into account all of the facts and circumstances, there has been a license of Program X to Corp B. Under paragraph (f)(1) of this section, there has not been a transfer of all substantial rights in the copyright to Program X because Corp A has the right to enter into other licenses with respect to the copyright of Program X, including licenses in Country Z (or even to sell that copyright, subject to Corp B's interest). Corp B has acquired no right itself to license the copyright rights in Program X. Finally, the term of the license is for less than the remaining life of the copyright in Program X.

(7) *Example 7: Sale of disks containing copies of a computer program to a distributor*—(i) *Facts.* Corp C, a distributor, enters into an agreement with Corp A to purchase as many copies of Program X on disk as it may from time-to-time request. Corp C will then sell these disks to retailers. The disks are shipped in boxes covered by shrink-wrap licenses (identical to the license described in paragraph (h)(1) of this section (*Example 1*)).

(ii) *Analysis.* (A) Under paragraph (b)(1) of this section, the transfers of

disks with copies of Program X from Corp A to Corp C are digital content transactions with one element, which is the transfer of copies of Program X. Therefore, the transactions are classified solely as the transfer of copyrighted articles under paragraph (b)(1)(ii) of this section. The use of the term license is not dispositive under paragraph (g)(1) of this section.

(B) Taking into account all of the facts and circumstances, Corp C is properly treated as the owner of copyrighted articles. Therefore, under paragraph (f)(2) of this section, there has been a sale of copyrighted articles.

(8) *Example 8: License to a computer manufacturer of copyright rights to make and load copies of a computer program onto the hard drive of computers*—(i) *Facts.* Corp A transfers a disk containing Program X to Corp D, a foreign corporation engaged in the manufacture and sale of personal computers in Country Z. Corp A grants Corp D the non-exclusive right to copy Program X onto the hard drive of an unlimited number of computers, which Corp D manufactures, and to distribute those copies (on the hard drive) to the public. The term of the agreement is two years, which is less than the remaining life of the copyright in Program X. Corp D pays Corp A an amount based on the number of copies of Program X it loads on to computers. Corp A has ascertained that the primary benefit or value from the transaction to Corp D is the ability to copy and distribute Program X onto computers manufactured by Corp D, not from the receipt of a copy of Program X. The transfer of a copy of Program X is merely the means by which Corp A provides Corp D access to Program X in order to exercise its right to make and distribute copies.

(ii) *Analysis.* (A) The transaction between Corp A and Corp D has multiple elements. One element is the transfer of a disk with a copy of Program X, which would be described in paragraph (b)(1)(ii) of this section (transfer of a copyrighted article) if considered separately. Another element is the grant of the non-exclusive right to copy Program X onto the hard drive of an unlimited number of computers and distribute those copies (on the hard drive) to the public, which would be described in paragraphs (b)(1)(i) and (c)(2)(i) of this section (transfer of a copyright right) if considered separately.

(B) Because the transaction has multiple elements, one or more of which would be a digital content transaction if considered separately, paragraph (b)(2) of this section provides that the transaction is classified within a single category under paragraph (b)(1) of this section if its predominant character is described in that paragraph. Pursuant to paragraph (b)(3) of this section, the predominant character of the transaction is based on the primary benefit or value of the transaction to the customer, if it is reasonably ascertainable. The predominant character of this transaction is therefore the transfer of copyright rights because the primary benefit or value received by Corp D is the right to copy Program X onto the hard drive of an unlimited number of computers and sell those copies (on the hard drive) to the public. Therefore, this transaction is classified solely as a transfer of copyright rights described in paragraph (b)(1)(i) of this section.

(C) Taking into account all of the facts and circumstances, there has been a license of Program X to Corp D. Under paragraph (f)(1) of this section, there has not been a transfer of all substantial rights in the copyright to Program X because Corp A has the right to enter into other licenses with respect to the copyright of Program X, including licenses in Country Z (or even to sell that copyright, subject to Corp D's interest). Corp D has acquired no right itself to license the copyright rights in Program X. Finally, the term of the license is for less than the remaining life of the copyright in Program X. The result would be the same if Corp D included with the computers it sells a copy of Program X on a disk.

(9) *Example 9: Sale of disks containing a copy of computer program to a computer manufacturer*—(i) *Facts.* The facts are the same as those in paragraph (h)(8) of this section (*Example 8*), except that Corp D, the Country Z corporation, receives physical disks. The disks are shipped in boxes covered by shrink-wrap licenses (identical to the licenses described in paragraph (h)(1) of this section (*Example 1*)). The terms of these licenses do not permit Corp D to make additional copies of Program X. Corp D uses each individual disk only once to load a single copy of Program X onto each separate computer. Corp D transfers the disk with the computer when it is sold.

(ii) *Analysis.* (A) Under paragraph (b)(1) of this section, the transfers of disks with copies of Program X from Corp A to Corp D are digital content transactions with one element, which is the transfer of copies of Program X. Therefore, the transaction is classified solely as the transfer of copyrighted articles under paragraph (b)(1)(ii) of this section. Corp D acquires the disks without the right to reproduce and distribute publicly further copies of Program X.

(B) Taking into account all of the facts and circumstances, Corp D is properly treated as the owner of copyrighted articles. Therefore, under paragraph (f)(2) of this section, the transaction is classified as the sale of a copyrighted article. The result would be the same if Corp D used a single physical disk to copy Program X onto each computer, and transferred an unopened box containing Program X with each computer, if Corp D were not permitted to copy Program X onto more computers than the number of individual copies purchased.

(10) *Example 10: Sale of a computer program with right to load onto multiple employee workstations*—(i) *Facts.* Corp A transfers a disk containing Program X to Corp E and grants Corp E the right to load Program X onto 50 individual workstations for use only by Corp E employees at one location in return for a one-time per-user fee (generally referred to as a site license or enterprise license). If additional workstations are subsequently introduced, Program X may be loaded onto those machines for additional one-time per-user fees. The license which grants the rights to operate Program X on 50 workstations also prohibits Corp E from selling the disk (or any of the 50 copies) or reverse engineering the program. The term of the license is stated to be perpetual.

(ii) *Analysis.* (A) It must be determined whether the transfer from Corp A to Corp E of a disk containing a copy of Program X and the right to load Program X onto 50 individual workstations is a transaction with multiple elements. There is at least one element, which is the transfer of a disk containing a copy of Program X, which either is a digital content transaction under paragraph (b)(1) of this section or would be a digital content transaction if considered separately. If there is no additional element, then the transaction is classified as a transfer of a copyrighted article pursuant to paragraph (b)(1)(ii) of this section. If there is a second element, then paragraph (b)(2) of this section applies and the transaction is classified within a single category under paragraph (b)(1) of this section if its predominant character is described in that paragraph. The grant of a right to copy, unaccompanied by the right to distribute those copies to the public, is not the transfer of a copyright right described in paragraph (c)(2) of this section. Therefore, there is no second element in this transaction and it is classified solely as the transfer of

copyrighted articles (50 copies of Program X).

(B) Taking into account all of the facts and circumstances, Corp E is properly treated as the owner of copyrighted articles. Therefore, under paragraph (f)(2) of this section, there has been a sale of copyrighted articles rather than the grant of a lease. Notwithstanding the restriction on sale, other factors such as, for example, the risk of loss and the right to use the copies in perpetuity outweigh, in this case, the restrictions placed on the right of alienation.

(C) The result would be the same if Corp E were permitted to copy Program X onto an unlimited number of workstations used by employees of either Corp E or other persons that had a relationship to Corp E specified in paragraph (g)(3) of this section.

(11) *Example 11: Sale of a computer program with right to make available to multiple employees via local area network*—(i) *Facts.* The facts are the same as those in paragraph (h)(10) of this section (*Example 10*), except that Corp E, the Country Z corporation, acquires the right to make Program X available to workstation users who are Corp E employees by way of a local area network (LAN). The number of users that can use Program X on the LAN at any one time is limited to 50. Corp E pays a one-time fee for the right to have up to 50 employees use the program at the same time.

(ii) *Analysis.* Under paragraph (g)(2) of this section the mode of utilization is irrelevant. Therefore, as in paragraph (h)(10) of this section (*Example 10*), this is a digital content transaction with a single element that is classified as the transfer of a copyrighted article pursuant to paragraph (b)(1)(ii) of this section. Under the benefits and burdens test of paragraph (f)(2) of this section, this transaction is a sale of copyrighted articles. The result would be the same if an unlimited number of Corp E employees were permitted to use Program X on the LAN or if Corp E were permitted to copy Program X onto LANs maintained by persons that had a relationship to Corp E specified in paragraph (g)(3) of this section.

(12) *Example 12: Lease of a computer program with right to receive upgrades and technical support services*—(i) *Facts.* The facts are the same as in paragraph (h)(11) of this section (*Example 11*), except that instead of paying a one-time fee, Corp E pays a monthly fee to Corp A calculated with reference to the permitted maximum number of users (which can be changed) and the computing power of Corp E's server. In return for this monthly fee, Corp E receives the right to receive upgrades of Program X when they become available. The agreement may be terminated by either party at the end of any month. When the disk containing the upgrade is received, Corp E must return the disk containing the earlier version of Program X to Corp A. If the contract is terminated, Corp E must delete (or otherwise destroy) all copies made of the current version of Program X. The agreement also requires Corp A to provide technical support in the form of troubleshooting and configuration assistance to Corp E, but the agreement does not allocate the monthly fee between the right to use Program X, the right to receive upgrades of Program X, and the technical support services. The amount of technical support that Corp A will provide to Corp E is not foreseeable when the contract is entered into but is expected to be minimal. Corp A has ascertained that the primary benefit or value to Corp E from the transaction is the right to use Program X on the LAN (without the ability to exercise any of the rights described in paragraphs (c)(2)(i) through (iv) of this section), not the receipt of technical support services with respect to Program X.

(ii) *Analysis.* (A) The transaction between Corp A and Corp E has multiple elements. One element is the transfer of a disk with a copy of Program X, which would be described in paragraph (b)(1)(ii) of this section (transfer of a copyrighted article) if considered separately. Another element is the provision of technical support services, which are not services for the development or modification of Program X described in paragraph (d) of this section because Corp E has received no copyright rights with respect to Program X. Thus, the technical support services would not be described in any of the categories in paragraph (b)(1) of this section if considered separately.

(B) Because the transaction has multiple elements, one or more of which would be a digital content transaction if considered separately, paragraph (b)(2) of this section provides that the transaction is classified within a single category under paragraph (b)(1) of this section if its predominant character is described in that paragraph. Pursuant to paragraph (b)(3) of this section, the predominant character of the transaction is based on the primary benefit or value of the transaction to the customer. The predominant character of this transaction is therefore the transfer of a copyrighted article because the primary benefit or value received by Corp E is the right to use Program X. Accordingly, this transaction is classified solely as a transfer of a copyrighted article described in paragraph (b)(1)(ii) of this section.

(C) Taking into account all facts and circumstances, under the benefits and burdens test Corp E is not properly treated as the owner of the copyrighted article. Corp E does not receive the right to use Program X in perpetuity, but only for so long as it continues to make payments. Corp E does not have the right to purchase Program X on advantageous (or, indeed, any) terms once a certain amount of money has been paid to Corp A or a certain period has elapsed (which might indicate a sale). Once the agreement is terminated, Corp E will no longer possess any copies of Program X, current or superseded. Therefore, under paragraph (f)(2) of this section there has been a lease of a copyrighted article.

(13) *Example 13: Sale of a computer program along with right to receive upgrades*—(i) *Facts.* The facts are the same as those in paragraph (h)(12) of this section (*Example 12*), except that, while Corp E must return copies of Program X as new upgrades are received, if the agreement terminates, Corp E may keep the latest version of Program X (although Corp E is still prohibited from selling or otherwise transferring any copy of Program X).

(ii) *Analysis.* For the reasons stated in paragraph (h)(10)(ii)(B) of this section (*Example 10*), the transfer of the program will be treated as a sale of a copyrighted article rather than as a lease.

(14) *Example 14: Sale of a modified computer program*—(i) *Facts.* Corp G enters into a contract with Corp A for Corp A to modify Program X so that it can be used at Corp G's facility in Country Z. Under the contract, Corp G is to acquire one copy of the program on a disk and the right to use the program on 5,000 workstations. The contract requires Corp A to rewrite elements of Program X so that it will conform to Country Z accounting standards and states that Corp A retains all copyright rights in the modified Program X. The agreement between Corp A and Corp G is otherwise identical as to rights and payment terms as the agreement described in paragraph (h)(10) of this section (*Example 10*).

(ii) *Analysis.* (A) It must be determined whether the transfer of disks with modified copies of Program X from Corp A to Corp G is a transaction with multiple elements. There is at least one element, the transfer of copies of Program X, which either is a digital content transaction under paragraph (b)(1) of this section or would be a digital content transaction if considered separately. If there is no additional

element, then the transaction is classified as a transfer of a copyrighted article pursuant to paragraph (b)(1)(ii) of this section. If there is a second element, then paragraph (b)(2) of this section applies and the transaction is classified within a single category under paragraph (b)(1) of this section if its predominant character is described in that paragraph. Pursuant to paragraph (d) of this section, the modifications made by Corp A before transferring Program X to Corp G do not constitute the provision of services for the development or modification of digital content because Corp A retains all copyright rights with respect to the modified software. Therefore, there is no second element in this transaction and it is classified solely as the transfer of copyrighted articles.

(B) Taking into account all facts and circumstances, Corp G is properly treated as the owner of copyrighted articles. Therefore, under paragraph (f)(2) of this section, there has been the sale of a copyrighted article rather than the grant of a lease.

(15) *Example 15: Provision of services for development of a computer program*—(i) *Facts.* Corp H enters into a license agreement for a new computer program. Program Q is to be written by Corp A. Corp A and Corp H agree that Corp A is writing Program Q for Corp H and that, when Program Q is completed, the copyright in Program Q will belong to Corp H. Corp H gives instructions to Corp A programmers regarding program specifications. Corp H agrees to pay Corp A a fixed monthly sum during development of the program. If Corp H is dissatisfied with the development of the program, it may cancel the contract at the end of any month. In the event of termination, Corp A will retain all payments, while any procedures, techniques or copyrightable interests will be the property of Corp H. All of the payments are labelled royalties. There is no provision in the agreement for any continuing relationship between Corp A and Corp H, such as the furnishing of updates of the program, after completion of the modification work.

(ii) *Analysis.* Under paragraph (b)(1) of this section, the provision of computer program development services by Corp A to Corp H is a digital content transaction with one element, which is the provision of services for the development or modification of digital content. Under paragraph (d) of this section, the transaction between Corp A and Corp H involves the provision of services for the development of a computer program because Corp H bears all of the risks of loss associated with the development of Program Q and is the owner of all copyright rights in Program Q. Taking into account all of the facts and circumstances, Corp A is treated as providing services to Corp H described in paragraph (b)(1)(iii) of this section. Under paragraph (g)(1) of this section, the fact that the agreement is labelled a license is not controlling (nor is the fact that Corp A receives a sum labelled a royalty).

(16) *Example 16: Provision of know-how by computer programmers*—(i) *Facts.* Corp A and Corp I, a Country Z corporation, agree that a development engineer employed by Corp A will travel to Country Z to provide know-how relating to certain techniques not generally known to computer programmers, which will enable Corp I to more efficiently create computer programs. These techniques represent the product of experience gained by Corp A from working on many computer programming projects, and are furnished to Corp I under nondisclosure conditions. Such information is property subject to trade secret protection.

(ii) *Analysis.* The provision of know-how with respect to computer programming techniques by Corp A's development engineer to Corp I is described in paragraph (e) of this section. Therefore, the transaction is a digital content transaction with one element, which is the provision of know-how. The transaction is classified solely as the provision of know-how pursuant to paragraph (b)(1)(iv) of this section.

(17) *Example 17: Sale of development program in transaction with multiple elements*—(i) *Facts.* Corp A transfers a disk containing Program Y to Corp E in exchange for a single fixed payment. Program Y is a computer program development program, which is used to create other computer programs, consisting of several components, including libraries of reusable software components that serve as general building blocks in new software applications. Because a computer program created with the use of Program Y will not operate unless the libraries are also present, the license agreement between Corp A and Corp E grants Corp E the right to distribute copies of the libraries with any program developed using Program Y. The license agreement is otherwise identical to the license agreement in paragraph (h)(1) of this section (*Example 1*). Corp A cannot reasonably ascertain the primary benefit or value of the transaction to Corp E. A customer like Corp E derives two benefits from this or a substantially similar transaction, the first of which is the ability to use Program Y to develop new software and the second of which is the right to utilize the libraries and reusable software components in Program Y in distributed programs. Corp A possesses data arising from market research and customer surveys indicating that customers utilize Program Y primarily for its computer program development features and do not make significant use of the libraries of reusable software components. The libraries and reusable software components are not significant components of any overall new program created by using Program Y.

(ii) *Analysis.* (A) The transaction between Corp A and Corp E has multiple elements. One element is the transfer of a disk with a copy of Program Y, which would be described in paragraph (b)(1)(ii) of this section (transfer of a copyrighted article) if considered separately. Another element is the grant of the right to distribute copies of the libraries of reusable software components with any program developed using Program Y, which would be described in paragraphs (b)(1)(i) and (c)(2)(i) of this section (transfer of a copyright right) if considered separately.

(B) Because the transaction has multiple elements, one or more of which would be a digital content transaction if considered separately, paragraph (b)(2) of this section provides that the transaction is classified within a single category under paragraph (b)(1) of this section if its predominant character is described in that paragraph. Pursuant to paragraph (b)(3)(i) of this section, the predominant character of a transaction is generally based on the primary benefit or value of the transaction to the customer. If the primary benefit or value is not reasonably ascertainable, paragraph (b)(3)(ii) of this section provides that the predominant character of a transaction may be determined based on the primary benefit or value to a typical customer of a substantially similar transaction. This primary benefit or value to a typical customer can be identified through actual data about use or access pursuant to paragraph (b)(3)(ii)(A) of this section, or if that data is not available, by other evidence indicative of the primary benefit or value to a typical customer pursuant to paragraph (b)(3)(ii)(B) of this section. Although there are two benefits in this type of transaction, Corp A possesses data indicating that a typical customer primarily uses Program Y because of its computer program development features, rather than the right to

distribute reusable components. This is reinforced by the fact that programs created using Program Y do not contain libraries of reusable software components as significant components. These facts indicate that the primary benefit or value to a typical customer arises from the ability to use Program Y, rather than the right to distribute reusable components. Therefore, the predominant character of this transaction is the transfer of a copy of Program Y, and this transaction is thus classified solely as the transfer of a copyrighted article described in paragraph (b)(1)(ii) of this section.

(C) Taking into account all the facts and circumstances, Corp E is properly treated as the owner of a copyrighted article. Therefore, under paragraph (f)(2) of this section, there has been the sale of a copyrighted article rather than the grant of a lease.

(18) *Example 18: Sale of a computer program with right to make modifications*—(i) *Facts.* Corp A transfers a disk containing Program X to Corp E. The disk contains both the object code and the source code to Program X, and the license agreement grants Corp E the right to modify the source code to correct minor errors and make minor adaptations to Program X so it will function on Corp E's computer; as well as the right to recompile the modified source code. The license does not grant Corp E the right to distribute the modified Program X to the public. The license is otherwise identical to the license agreement in paragraph (h)(1) of this section (*Example 1*). Corp A has ascertained that the primary benefit or value received by Corp E from the transaction is the core functionality of Program X rather than the limited rights to modify the source code.

(ii) *Analysis.* (A) The transaction between Corp A and Corp E has multiple elements. One element is the transfer of a disk with a copy of Program X, which would be described in paragraph (b)(1)(ii) of this section (transfer of a copyrighted article) if considered separately. Another element is the grant of the right to modify the source code to Program X and recompile the modified source code to create new code to correct minor errors, and to make minor adaptations to Program X, which would be described in paragraphs (b)(1)(i) and (c)(2)(ii) of this section (transfer of a copyright right) if considered separately.

(B) Because the transaction has multiple elements, one or more of which would be a digital content transaction if considered separately, paragraph (b)(2) of this section provides that the transaction is classified within a single category under the categories described under paragraph (b)(1) of this section if its predominant character is described in that paragraph. Pursuant to paragraph (b)(3) of this section, the predominant character of the transaction is based on the primary benefit or value of the transaction to the customer, if it is reasonably ascertainable. Since the primary benefit or value received by Corp E is the core functionality of Program X, rather than the limited rights to modify the source code, the predominant character of this transaction is the transfer of a copyrighted article. Therefore, this transaction is classified solely as a transfer of a copyrighted article under paragraph (b)(1)(ii) of this section.

(C) Taking into account all the facts and circumstances, Corp E is properly treated as the owner of a copyrighted article. Therefore, under paragraph (f)(2) of this section, there has been the sale of a copyrighted article rather than the grant of a lease.

(19) *Example 19: License to website operator to make and sell copies of electronic books via download*—(i) *Facts.* Corp A operates a website that offers electronic books for download onto customers' computers or other electronic devices. The books offered are protected by copyright law. In a transaction between Corp A and a content owner, Corp A receives from the content owner a digital master copy of a book, which Corp A downloads onto its server. Corp A receives the non-exclusive right to reproduce an unlimited number of copies of the book for purposes of distribution and sale to the public. Corp A pays the content owner a specified amount for each copy sold to a customer. Corp A may not transfer any of the rights it receives from the content owner. The term of the agreement Corp A has with the content owner is shorter than the remaining life of the copyright. The content owner has ascertained that the primary benefit or value Corp A receives in the transaction is the right to reproduce and distribute an unlimited number of copies of the book and not the transfer of a copy of the book. In a separate transaction, Corp A charges a customer a fixed fee for each book purchased. When purchasing a book from Corp A on Corp A's website, the customer must acknowledge the terms of a license agreement with the content owner that states that the customer may download and view the electronic book in perpetuity but may not reproduce, distribute, or sell copies of it. Once the customer downloads the book from Corp A's server onto a device, the customer may access and view the book from that device, which does not need to be connected to the internet for the customer to view the book. The customer owes no additional payment to Corp A for the ability to view the book in the future.

(ii) *Analysis.* (A) Notwithstanding the license agreement between each customer and the content owner granting the customer rights to use the book, the relevant transactions are the transfer of a master copy of the book along with the grant from the content owners to Corp A of the right to reproduce and sell to the public copies of the books, and the transfers of copies of the books by Corp A to customers. Although the content owner is identified as a party to the license agreement memorializing the customer's rights with respect to the book, each customer obtains those rights directly from Corp A, not from the content owner. Under paragraph (b)(1) of this section, the download of a copy of a book by a customer is a digital content transaction with one element, which is the transfer of a digital copy of a book. Therefore, the transaction is treated solely as a transfer of a copyrighted article under paragraph (b)(1)(ii) of this section. Under the benefits and burdens test of paragraph (f)(2) of this section, the transaction is classified as a sale and not a lease, because the customer receives the right to view the book in perpetuity on its device.

(B) The transaction between the content owner and Corp A has multiple elements. One element is the transfer of a master copy of the book, which would be described in paragraph (b)(1)(ii) of this section (transfer of a copyrighted article) if considered separately. Another element is the grant of the right to reproduce and sell an unlimited number of copies to customers, which would be described in paragraphs (b)(1)(i) and (c)(2)(i) of this section (transfer of a copyright right) if considered separately. Because the transaction has multiple elements, one or more of which would be a digital content transaction if considered separately, paragraph (b)(2) of this section provides that the transaction is classified within a single category under the categories described under paragraph (b)(1) of this section if its predominant character is described in that paragraph. Pursuant to paragraph (b)(3) of this section, the predominant character of the transaction is based on the primary benefit or value of the transaction to the customer, if it is reasonably ascertainable. Since the primary benefit or value Corp A receives in the transaction is the right to reproduce and distribute an unlimited

number of copies, the predominant character of this transaction is the transfer of a copyright right. Therefore, this transaction is classified solely as a transfer of copyright rights described in paragraph (b)(1)(i) of this section.

(C) Taking into account all of the facts and circumstances, there has been a license of books to Corp A. Under paragraph (f)(1) of this section, there has not been a transfer of all substantial rights in the copyright rights to the books because each content owner has the right to enter into other licenses with respect to the copyright of their book. Corp A has acquired no right itself to license the copyrights in the books. Finally, the terms of the licenses are for less than the remaining lives of the copyrights in the books.

(20) *Example 20: internet platform operator as agent for application developers*—(i) *Facts.* Corp A operates a platform on the internet that offers applications for download onto a customer's mobile phone. Under general tax principles, Corp A and an application developer establish an agency relationship whereby Corp A acts as the agent to offer the application for sale to customers on behalf of the application developer. The applications are protected by copyright law. Under the agreement between Corp A and the application developer, Corp A agrees to provide the application developer with platform and agency services to facilitate the sale of the application to customers. Corp A also provides the application developer with hosting services to host the application on Corp A's servers for download by the customers. Corp A receives a digital master copy of the application along with a non-exclusive right to make copies of the application and allow customers to download copies of the application from Corp A's platform. Corp A has ascertained that the primary benefit or value from the transaction received by the application developer is the platform and agency services that Corp A provides. Corp A receives the right to make copies of the application merely to perform its activities as an agent on behalf of the application developer. When purchasing an application on Corp A's platform, the customer must acknowledge the terms of a license agreement with the application developer that states that the customer may use the application but may not reproduce or distribute copies of it. In addition, the agreement provides that the customer may download the application onto only one mobile phone at a time. A customer does not need to be connected to the internet to access the application. The customer owes no additional payment to Corp A or the application developer for the ability to use the application in perpetuity. Corp A retains a fixed percentage of each purchase price of the application and remits the remaining balance to the application developer.

(ii) *Analysis.* (A) The transaction between Corp A and the application developer has multiple elements. One element is the transfer of a master copy of an application by the application developer to Corp A, which would be described in paragraph (b)(1)(ii) of this section (transfer of a copyrighted article) if considered separately. Another element is the transfer of the right to make and distribute copies of the application by the application developer to Corp A, which would be described in paragraphs (b)(1)(i) and (c)(2) of this section (transfer of a copyright right) if considered separately. A third element is the platform and agency services provided by Corp A to the application developer, which would not be described in this section if considered separately. A fourth element is the hosting services provided by Corp A to the application developer, which would be described in § 1.861–19 if considered separately. Under the facts and circumstances, although Corp A receives a copy of the application and the right to make and distribute copies of the application, Corp A receives this copy and right merely to facilitate the sale of applications on behalf of the application developer.

(B) Because the transaction has multiple elements, one or more of which would be a digital content transaction if considered separately, paragraph (b)(2) of this section provides that the transaction is classified within a single category under the categories described under paragraph (b)(1) of this section if its predominant character is described in that paragraph. Pursuant to paragraph (b)(3) of this section, the predominant character of the transaction is based on the primary benefit or value of the transaction to the customer, if it is reasonably ascertainable. Since the primary benefit or value the application developer receives in the transaction is the platform and agency services, the predominant character of this transaction is the platform and agency services and not a digital content transaction nor a cloud transaction.

(C) The transfer of a copy of an application from the application developer to a customer is a digital content transaction with one element, which is the transfer of a copy of a digital program. Therefore, the transaction is treated solely as a transfer of a copyrighted article under paragraph (b)(1)(ii) of this section. Under the benefits and burdens test of paragraph (f)(2) of this section, this transaction is a sale of a copyrighted article because a customer has the right to use the application in perpetuity.

(21) *Example 21: Movies and TV shows available for stream, rent, or purchase*—(i) *Facts.* Corp A offers a catalog of movies and TV shows, all of which are subject to copyright protection. Corp A gives customers several options for viewing the content, each of which has a separate price. A ''streaming'' option allows a customer to view the video, which is hosted on Corp A's servers, while connected to the internet for as many times as the customer wants during a limited period. A ''rent'' option allows a customer to download the video to its computer or other electronic device (which does not need to be connected to the internet for viewing) and watch the video as many times as the customer wants for a limited period, after which an electronic lock is activated and the customer may no longer view the content. A ''purchase'' option allows a customer to download the video and view it as many times as the customer chooses with no end date. Under all three options, the customer may view the video but may not reproduce or distribute copies of it, prepare derivative works based on it, or publicly display it.

(ii) *Analysis.* (A) With respect to the ''rent'' option, under paragraph (b)(1) of this section the download of a video by a customer is a digital content transaction with one element, which is the transfer of a copy of the video. Therefore, the transaction is treated solely as the transfer of a copyrighted article under paragraph (b)(1)(ii) of this section. Although a customer will retain a copy of the content at the end of the payment term, the customer cannot access the content after the electronic lock is activated. The activation of the electronic lock is the equivalent of having to return the copy. Therefore, the transaction is classified as a lease of a copyrighted article under paragraph (f)(2) of this section because the customer's right to view the videos is for a limited period.

(B) With respect to the ''purchase'' option, under paragraph (b)(1) of this section the download of a video by a customer is a digital content transaction with one element, which is the transfer of a copy of the video. Therefore, the transaction is treated solely as the transfer of a copyrighted article under paragraph (b)(1)(ii) of this section. The transaction is classified as a sale of a copyrighted article under paragraph

(f)(2) of this section because the customer receives the right to view the videos in perpetuity.

(C) With respect to the ''streaming'' option, the transaction is Corp A's grant of the right to its customers to view the movies or shows while connected to the internet for a limited period. There is no transfer of any copyright rights described in paragraph (c)(2) of this section. There is also no transfer of a copyrighted article because the content is not downloaded by a customer, but rather, is accessed through an on-demand network. The transaction also does not constitute the provision of services for the development of digital content or the provision of know-how under paragraph (b)(1) of this section. Therefore, the transaction is not a digital content transaction described in paragraph (b)(1) of this section. Instead, the transaction is a cloud transaction that is classified under § 1.861–19. See § 1.861–19(b).

(22) *Example 22: Website offering third-party videos via stream*—(i) *Facts.* Corp A operates a website that allows customers to stream videos that third-party content creators upload to Corp A's website. Corp A has advertising contracts with third-party advertisers pursuant to which Corp A earns advertising revenue when a customer views a video. Customers can either stream videos for free with advertisements or can pay a subscription fee to stream videos without advertisements. Under the contract between Corp A and content creators, content creators retain all ownership rights in their videos and must own or have the necessary rights to publish their videos. The contract also states that content creators grant Corp A a non-exclusive license to use, reproduce, distribute, and display their videos in connection with Corp A's website, and grant customers a non-exclusive license to view the videos. These licenses terminate within a commercially reasonable time after a content creator removes or deletes a video from Corp A's website. Content creators have ascertained that the primary benefit or value Corp A receives from transactions with content creators is the right to use, reproduce, distribute, and display their videos. Corp A pays content creators a percentage of advertising revenue generated from the videos and a percentage of subscription fees.

(ii) *Analysis.* (A) The transaction between Corp A and the content creators has multiple elements. One element is the uploading of a video by a content creator, which would be described in paragraph (b)(1)(ii) of this section (transfer of a copyrighted article) if considered separately. Another element is the grant by content creators to Corp A of the right to use, reproduce, distribute, and display their videos, which would be described in paragraph (b)(1)(i) of this section (transfer of a copyright right) if considered separately. Content creators are not providing content development services to Corp A under paragraph (d) of this section because content creators own the copyright rights in the videos.

(B) Because the transaction has multiple elements, one or more of which would be a digital content transaction if considered separately, paragraph (b)(2) of this section provides that the transaction is classified within a single category under the categories described under paragraph (b)(1) of this section if its predominant character is described in that paragraph. Pursuant to paragraph (b)(3) of this section, the predominant character of the transaction is based on the primary benefit or value of the transaction to the customer. The predominant character of the transaction is therefore the transfer of copyright rights because the primary benefit or value received by Corp A is the right to use, reproduce, distribute, and display videos. Accordingly, this transaction is characterized solely as a transfer of a copyright right as described in paragraphs (b)(1)(i) of this section.

(C) Taking into account all of the facts and circumstances, there has been a license of videos to Corp A. Under paragraph (f)(1) of this section, there has not been a transfer of all substantial rights in the copyright rights to the videos because each content owner has the right to enter into other licenses with respect to the copyright of their videos. Corp A has acquired no right itself to license the copyrights in the videos. Finally, the terms of the licenses are for less than the remaining lives of the copyrights in the videos.

(D) For both the free streaming and subscription streaming transactions between Corp A and customers, there is no transfer of any copyright rights described in paragraph (c)(2) of this section. There is also no transfer of a copyrighted article, because the content is not downloaded by a customer, but rather is accessed through an on-demand network. The transactions also do not constitute the provision of services for the development of digital content or the provision of know-how under paragraph (b)(1) of this section. Therefore, paragraph (b)(1) of this section does not apply to such transactions. Instead, both transactions are cloud transactions that are classified under § 1.861–19. See § 1.861–19(b).

(23) *Example 23: Sale of computer programs electronically through a reseller*—(i) *Facts.* Corp A owns the copyright to software (Program S). Corp A hosts Program S on its servers. Corp A grants Corp B, a foreign corporation wholly owned by Corp A, the right to distribute copies of Program S (without the right to reproduce copies of Program S) to Corp B's customers that are located in Corp B's country. Under the agreement between Corp A and Corp B, Corp B pays Corp A a fixed fee for each copy of Program S that Corp A delivers to a customer. In separate transactions, customers pay Corp B for the right to receive digital copies of Program S that they may then use in perpetuity without further payment. Corp B is responsible for managing the purchase/sale interaction with Corp B's customers, including invoicing and collections. Corp A is responsible for creating and delivering the digital copies of Program S to Corp B's customers from Corp A's servers. Corp B does not perform any functions to provide access to Program S.

(ii) *Analysis.* (A) Although there is a single contract between Corp A and Corp B that grants a legal right to Corp B with respect to Program S, that right (the right to distribute) is not a copyright right described in paragraphs (b)(1)(i) and (c)(2) of this section. Instead, the transactions between Corp A and Corp B and then Corp B and its customers are functionally and economically equivalent to back-to-back transfers of copyrighted articles. The transfers are only superficially different from those described in paragraph (h)(24) of this section (*Example 24*) where the reseller acquires product keys and sells them on to customers. Therefore, each sale of a copy of Program S by Corp B to a customer should be viewed as a transfer of a copyrighted article from Corp A to Corp B and then from Corp B to the customer.

(B) The transaction between Corp A and Corp B is a digital content transaction with a single element that is classified as a transfer of a copyrighted article described in paragraph (b)(1)(ii) of this section. There are no additional elements because Corp B's receipt of the right to distribute copies of Program S (without the right to make copies) is not a copyright right described in paragraph (c)(2) of this section. Under the benefits and burdens test of paragraph (f)(2) of this section, the transfer is classified as the sale of a copyrighted article.

(C) The transaction between Corp B and a customer is a digital content transaction with a single element that is classified as a transfer of a copyrighted article described in paragraph (b)(1)(ii)

of this section. Under the benefits and burdens test of paragraph (f)(2) of this section, this transaction is a sale of a copyrighted article because the customer has the right to use the application in perpetuity.

(24) *Example 24: Sale of video games with online and offline functionality through retailers using digital keys*—(i) *Facts.* Corp A owns the copyright in a computer program (Program Y). Corp A creates digital keys that allow for the download of one copy of Program Y from Corp A's website. Corp A sells these digital keys to retailers for a one-time fee per key, and the retailers do not use Program Y, but instead sell them in separate transactions to customers for a one-time fee per key. Corp A ascertains that the primary benefit or value to retailers from the purchase of digital keys from Corp A is the right to further transfer the digital keys to customers. The retailers cannot reasonably ascertain the primary benefit or value that their specific customers derive from Program Y, nor is there data available to the retailers about how their customers typically use Program Y. Program Y is a video game that contains online and offline features, both of which can be played without paying an additional game-specific cost after paying the one-time fee to purchase a key. The offline feature is comprised of a single-player story that does not require any internet connection to play. The online feature is comprised of the ability to play competitive matches against other players that are hosted on servers owned by Corp A. The competitive matches require an ongoing connection to the internet to play. Neither the customers nor the retailer receives any copyright rights described in paragraph (c)(2) of this section with respect to Program Y. Customers can use Program Y in perpetuity. Program Y is primarily marketed as a single-player game in television and online advertising, with only brief mentions of the multiplayer mode in print advertising. The development cost for Program Y was allocated 40% to developing the single-player content, 20% to developing the multiplayer content, and 40% to developing content that is used by both types of content (*e.g.,* cost of developing the game engine).

(ii) *Analysis.* (A) The transaction between Corp A and a retailer has multiple elements. One element is the transfer of a key with the right to download a copy of Program Y for use to play the offline story, which would be a digital content transaction described in paragraph (b)(1)(ii) of this section (transfer of a copyrighted article) if considered separately. Another element is the transfer of the same key with a copy of Program Y providing on-demand network access to digital content in the form of competitive multiplayer functionality, which would be a cloud transaction described in § 1.861–19(b) if considered separately.

(B) Because the transaction has multiple elements, one of which would be a digital content transaction if considered separately and one of which would be a cloud transaction if considered separately, paragraph (b)(2) of this section provides that the transaction is classified within a single category under paragraph (b)(1) of this section if its predominant character is described in that paragraph, or the transaction is classified solely as a cloud transaction if its predominant character is a cloud transaction pursuant to § 1.861–19(c)(2). Pursuant to paragraph (b)(3)(i) of this section, the predominant character of the transaction is based on the primary benefit or value of the transaction to the customer, if it is reasonably ascertainable. The predominant character of this transaction is therefore the transfer of copyrighted articles because the primary benefit or value received by a retailer is the right to further transfer the same copyrighted articles to customers in the form of digital keys. The retailers do not have any intent to utilize the cloud functionality of the digital keys, although they do have the right to do so. Therefore, this transaction is classified solely as a transfer of copyrighted articles described in paragraph (b)(1)(ii) of this section.

(C) Under the benefits and burdens test of paragraph (f)(2) of this section, the transfer between Corp A and a retailer is classified as the sale of a copyrighted article because the retailer has the right to use, or sell, Program Y in perpetuity without further payment.

(D) The transfer of a key (with the right to download a copy of Program Y) by a retailer to a customer also contains the same two elements as each transaction between Corp A and a retailer. However, a retailer cannot reasonably ascertain the primary benefit or value derived by a specific customer from Program Y. In such situations, paragraph (b)(3)(ii) of this section provides that the predominant character of a transaction may be determined based on the primary benefit or value to a typical customer of a substantially similar transaction. This primary benefit or value to a typical customer can be identified through actual data about use or access pursuant to paragraph (b)(3)(ii)(A) of this section, or if that data is not available, by using other evidence indicative of the primary benefit or value to a typical customer pursuant to paragraph (b)(3)(ii)(B) of this section. Because the retailers do not have available data about how customers use Program Y, they may use the marketing with respect to Program Y to determine that its predominant character is that of a transfer of a copyrighted article described in paragraph (b)(1)(ii) of this section. The relative development costs of the offline and online components of the game could also be used if they are known to a retailer. Therefore, the transfer between a retailer and a customer of a digital key containing the right to download a copy of Program Y is classified solely as a transfer of a copyrighted article.

(E) Under the benefits and burdens test of paragraph (f)(2) of this section, the transfer between a retailer and a customer is classified as the sale of a copyrighted article because the customer has the right to use Program Y in perpetuity without further payment.

(25) *Example 25: Source of income from the sale of a copyrighted article transferred through an electronic medium*—(i) *Facts.* Corp A is the parent company of a world-wide group of affiliated companies. Corp B is a foreign corporation wholly owned by Corp A. In the ordinary course of business, Corp B acts as a procurement hub for Corp A's affiliated companies. In this role, Corp B regularly purchases products that will be distributed amongst Corp A's affiliated companies to be used by them in their respective businesses. Corp B purchases digital copies of a computer program (Program Y) from Corp C, an unrelated company. Corp B may use Program Y in perpetuity without further payment. Corp B receives no copyright rights in Program Y. Corp B does not use Program Y, and instead distributes all of its copies of Program Y to various affiliates. Corp C sources income from the sale of Program Y using sections 861(a)(6) and 862(a)(6).

(ii) *Analysis.* (A) Under paragraph (b)(1) of this section, the transfer of Program Y from Corp C to Corp B is a digital content transaction with one element, which is the transfer of a copy of Program Y. Therefore, the transaction is treated solely as transfers of a copyrighted articles under paragraph (b)(1)(ii) of this section. Taking into account all of the facts and circumstances, there have been sales of copies of Program Y to Corp B under paragraph (f)(2) of this section.

(B) Income from the sale of Program Y by Corp C is sourced pursuant to sections 861(a)(6) and 862(a)(6) to the place where the sale occurred. Pursuant to paragraph (f)(2)(ii) of this section, a transfer of a copyrighted article through

an electronic medium is treated as occurring at the billing address of the purchaser, in this case Corp B, unless the sales transaction is arranged for a principal purpose of tax avoidance. In this case, the sale is treated as occurring at the billing address of Corp B, and Corp C's income is foreign source, even though Corp B will not use Program Y, because Corp B regularly purchases products that will be distributed amongst its affiliates to be used in their respective businesses, and therefore there is no evidence that Corp B was used by Corp A to purchase Program Y with a principal purpose of tax avoidance.

(26) *Example 26: Application of anti-abuse rule for sale of a copyrighted article transferred through an electronic medium*—(i) *Facts.* Corp A is the parent company of a world-wide group of affiliated companies. Corp B is a foreign affiliate of Corp A. In the ordinary course of business, Corp B does not act as a procurement hub regularly purchasing products for use by Corp A's affiliated companies. Corp A negotiates an agreement with Corp C, an unrelated company, to purchase digital copies of a computer program (Program Y) for use in Corp A's business. The agreement grants Corp A the right to use Program Y in perpetuity for a one-time payment. Corp C requests that Corp B be the purchaser of the copies of Program Y even though Corp B will not use Program Y and is not otherwise involved in the transaction between Corp A and Corp C for a principal purpose of tax avoidance. Corp A agrees, and Corp B purchases the copies of Program Y and subsequently distributes them to Corp A. Corp C sources income from the sale of Program Y using sections 861(a)(6) and 862(a)(6).

(ii) *Analysis.* (A) Under paragraph (b)(1) of this section, the transfer of Program Y from Corp C to Corp B is a digital content transaction with one element, which is the transfer of a copy of Program Y. Therefore, the transaction is classified solely as a transfer of a copyrighted article under paragraph (b)(1)(ii) of this section. Taking into account all of the facts and circumstances, there have been sales of copies of Program Y to Corp B under paragraph (f)(2) of this section.

(B) Income from the sale of Program Y by Corp C is sourced pursuant to sections 861(a)(6) and 862(a)(6) to the place where the sale occurred. Pursuant to paragraph (f)(2)(ii) of this section, a transfer of a copyrighted article through an electronic medium is treated as occurring at the billing address of the purchaser, in this case Corp B, unless the sales transaction is arranged for a principal purpose of tax avoidance. In this case, Corp B does not regularly purchase products that will be used by other companies within Corp A's group of affiliated companies, and Corp B was instead used as the purchaser of Program Y on behalf of Corp A with a principal purpose of tax avoidance. Therefore, the place where the sale occurred must be determined based on all relevant facts and circumstances. Corp A negotiated the purchase, and the software will be used by Corp A in its business. As a result, under paragraph (f)(2)(ii) of this section, the sale is treated as occurring at the location of Corp A and the income derived by Corp C from the sale is U.S. source.

(C) The same result would apply if, instead of using Corp B for the purchase, Corp A made the purchase but rented a P.O. Box outside the United States to serve as the billing address for the transaction with a principal purpose of tax avoidance.

(i) *Applicability date*—(1) *In general.* This section applies to taxable years beginning on or after January 14, 2025.

(2) *Early application.* A taxpayer can apply this section to taxable years beginning on or after August 14, 2019 and all subsequent taxable years not described in paragraph (i)(1) of this section (early application years) if—

(i) The taxpayer also applies § 1.861–19 to the early application years;

(ii) This section and § 1.861–19 are applied to the early application years by all persons related to the taxpayer (within the meaning of sections 267(b) and 707(b));

(iii) The period of limitations on assessment for each early application year of the taxpayer and all related parties (within the meaning of sections 267(b) and 707(b)) is open under section 6501; and

(iv) The taxpayer would not be required under this section to change its method of accounting as a result of such election.

(j) *Change in method of accounting required by this section.* In order to comply with this section, a taxpayer may be required to change its method of accounting. If so required, the taxpayer must secure the consent of the Commissioner in accordance with the requirements of § 1.446–1(e) and the applicable administrative procedures for obtaining the Commissioner's consent under section 446(e) for voluntary changes in methods of accounting.

■ **Par. 4** Section 1.861–19 is added to read as follows:

§ 1.861–19 Classification of cloud transactions.

(a) *In general.* This section provides rules for classifying cloud transactions (as defined in paragraph (b) of this section). The rules of this section apply for purposes of Internal Revenue Code sections 59A, 245A, 250, 267A, 367, 404A, 482, 679, and 1059A; subchapter N of chapter 1; chapters 3 and 4; and sections 842 and 845 (to the extent involving a foreign person), and apply with respect to transfers to foreign trusts not covered by section 679.

(b) *Cloud transaction defined.* A cloud transaction is a transaction through which a person obtains on-demand network access to computer hardware, digital content (as defined in § 1.861–18(a)(2)), or other similar resources. A cloud transaction does not include network access to download digital content for storage and use on a person's computer or other electronic device.

(c) *Classification of cloud transactions*—(1) *In general.* A cloud transaction is classified as the provision of services.

(2) *Transaction with multiple elements.* Taking into account the overall transaction and the surrounding facts and circumstances, a transaction that has multiple elements, one or more of which would be a cloud transaction if considered separately, is classified in its entirety as a cloud transaction if the predominant character of the transaction as determined under § 1.861–18(b)(3) is a cloud transaction.

(d) *Examples.* The examples in this paragraph (d) illustrate the provisions of this section. Unless otherwise specified, assume that Corp A is a domestic corporation, no rights described in § 1.861–18(c)(2) (copyright rights) are transferred as part of the transactions described, and all facts in each example occur as part of a single transaction.

(1) *Example 1: Computing capacity*—(i) *Facts.* Corp A operates data centers on its premises in various locations. Corp A provides Corp B computing capacity on Corp A's servers in exchange for a monthly fee based on the amount of computing power made available to Corp B. Corp B provides its own software to run on Corp A's servers.

(ii) *Analysis.* The provision of on-demand network computing capacity by Corp A to Corp B is a cloud transaction with one element. Therefore, the transaction is treated solely as a cloud transaction under paragraph (b) of this section and is classified as the provision of services under paragraph (c)(1) of this section.

(2) *Example 2: Computing capacity on dedicated on-premises servers*—(i) *Facts.* The facts are the same as in paragraph (d)(1)(i) of this section (the facts in *Example 1*), except that, in order to offer more security to Corp B, Corp A provides Corp B computing capacity exclusively through designated servers, which are owned and operated by Corp A and located at Corp B's facilities. Corp A agrees not to use the designated server for any other customer for the duration of its arrangement with Corp B. Although the server is located at Corp B's facilities, Corp B accesses the server through Corp A's network and the monthly fee is based on the amount of computing power made available to Corp B.

(ii) *Analysis.* As in paragraph (d)(1) of this section (*Example 1*), the transaction between Corp A and Corp B is the provision of on-demand network computing capacity and is therefore a cloud transaction with one element. Therefore, the transaction is treated solely as a cloud transaction under paragraph (b) of this section and is classified as the provision of services under paragraph (c)(1) of this section. If the transaction between Corp A and Corp B involved only the provision of a server by Corp A for use by Corp B, and not on-demand network access to computing capacity, the transaction would not be a cloud transaction and this section would not apply.

(3) *Example 3: Access to software development platform and website hosting*—(i) *Facts.* Corp A provides Corp B a software platform that Corp B uses to develop and deploy websites with a range of features, including blogs, message boards, and other collaborative knowledge bases. The software development platform consists of an operating system, web server software, scripting languages, libraries, tools, and back-end relational database software and allows Corp B to use in its websites certain visual elements subject to copyrights held by Corp A. The software development platform is hosted on servers owned by Corp A and located at Corp A's facilities. Corp B's finished websites are also hosted on Corp A's servers. Corp B accesses the software development platform via a standard web browser. Corp B has no ability to alter the software code. A small amount of copyrighted scripting code is downloaded onto Corp B's computers to facilitate secure logins and access to the software development platform. All other functions of the software development platform execute on Corp A's servers, and no portion of the core software code is ever downloaded by Corp B or Corp B's customers. Corp A has ascertained that the primary benefit or value to Corp B from the transaction is the right to use the software development platform. Corp B pays Corp A a monthly fee for the platform and website hosting.

(ii) *Analysis.* (A) There is one transaction with multiple elements between Corp A and Corp B. One element is Corp A's provision to Corp B of on-demand network access to the software platform, which would be a cloud transaction described in paragraph (b) of this section if considered separately. Another element is Corp A's hosting of Corp B's finished websites, which would be a cloud transaction described in paragraph (b) of this section if considered separately. A third element is the grant by Corp A to Corp B of the right to use in Corp B's websites certain visual elements subject to copyrights held by Corp A, which would be a transfer of copyright rights under § 1.861–18(b)(1)(i) if considered separately. A fourth element is the download of scripting code by Corp B, which would be a transfer of a copyrighted article under § 1.861–18(b)(1)(ii) if considered separately.

(B) Because the transaction has multiple elements, one or more of which would be a cloud transaction if considered separately, paragraph (c)(2) of this section provides that the transaction is classified as a cloud transaction if its predominant character is a cloud transaction. Pursuant to § 1.861–18(b)(3), the predominant character of the transaction is based on the primary benefit or value of the transaction to the customer, if it is reasonably ascertainable. The predominant character of this transaction is therefore a cloud transaction because the primary benefit or value received by Corp B is the right to use the software development platform. Accordingly, this transaction is classified solely as a cloud transaction described in paragraph (b) of this section and is classified as the provision of services under paragraph (c)(1) of this section.

(4) *Example 4: Access to online software via an application*—(i) *Facts.* Corp A provides Corp B word processing, spreadsheet, and presentation software and allows employees of Corp B to access the software over the internet through a web browser or an application (''app'') that can be downloaded from Corp A's servers onto a computer or mobile device. Corp B's employees usually download Corp A's app onto their mobile devices. To access the full functionality of the app, the device must be connected to the internet. Only a limited number of features on the app are available without an internet connection. Corp B has no ability to alter the software code. The software is hosted on servers owned by Corp A and located at Corp A's facilities and is used concurrently by other Corp A customers in addition to Corp B. Corp B pays a monthly fee based on the number of employees with access to the software. Users have the option to save files either online using the storage provided by Corp B, or offline on their own hard drives. Corp B's employees can also download updates to the app as part of the monthly fee arrangement. Upon termination of the arrangement, Corp A activates an electronic lock preventing Corp B's employees from further utilizing the app, and Corp B's employees are no longer able to access the software via a web browser. Corp A has ascertained that the primary benefit or value to Corp B from the transaction is the right to access Corp A's software over the internet, whether via web browser or after downloading the app.

(ii) *Analysis.* (A) There is one transaction with multiple elements between Corp A and Corp B. One element is Corp A's provision to Corp B of on-demand network access to Corp A's computer hardware and software resources for the purpose of fully utilizing Corp A's software, which would be a cloud transaction described in paragraph (b) of this section if considered separately. Another element is the download of Corp A's app by Corp B employees, which would be a transfer of a copyrighted article under § 1.861–18(b)(1)(ii) if considered separately.

(B) Because the transaction has multiple elements, one or more of which would be a cloud transaction if considered separately, paragraph (c)(2) of this section provides that the transaction is classified as a cloud transaction if its predominant character is a cloud transaction. Pursuant to § 1.861–18(b)(3), the predominant character of the transaction is based on the primary benefit or value of the transaction to the customer, if it is reasonably ascertainable. The predominant character of this transaction is therefore a cloud transaction because the primary benefit or value received by Corp B is the right to access Corp A's software over the internet. Accordingly, this transaction is classified solely as a cloud transaction described in paragraph (b) of this section and is classified as the provision of services under paragraph (c)(1) of this section.

(5) *Example 5: Access to offline software with limited online functions*—

(i) *Facts.* Corp A provides Corp B word processing, spreadsheet, and presentation software that is functionally similar to the software in paragraph (d)(4) of this section (*Example 4*). The software is made available for access over the internet but only to download the software from servers owned by Corp A onto a computer or mobile device in the form of an app. The downloaded software contains all the core functions of the software. Employees of Corp B can use the software on their computers or mobile devices regardless of whether their computer or mobile device is online. When online, the software provides a few ancillary functions that are not available offline, such as access to document templates and data collection for diagnosing problems with the software. Whether working online or offline, Corp B employees can store their files only on their own computer or mobile device, and not on Corp A's data storage servers. Corp B's employees can also download updates to the software as part of the monthly fee arrangement. Upon termination of the arrangement, an electronic lock is activated so that the software can no longer be accessed. Corp A has ascertained that the primary benefit or value to Corp B from the transaction is the right to download and use Corp A's software offline.

(ii) *Analysis.* (A) The transaction between Corp A and Corp B contains multiple elements. One element is the transfer of a copy of Corp A's software via download, which would be a transfer of a copyrighted article described under § 1.861–18(b)(1)(ii) if considered separately. Another element is the provision of online ancillary functionality of the software, which would be a cloud transaction described in paragraph (b) of this section if considered separately.

(B) Because the transaction has multiple elements, one or more of which would be a cloud transaction if considered separately, paragraph (c)(2) of this section provides that the transaction is classified as a cloud transaction if its predominant character is a cloud transaction. Pursuant to § 1.861–18(b)(3), the predominant character of the transaction is based on the primary benefit or value of the transaction to the customer, if it is reasonably ascertainable. The predominant character of this transaction is therefore the transfer of a copyrighted article because the primary benefit or value received by Corp B is the right to download and use Corp A's software offline. Accordingly, this transaction is classified solely as a transfer of a copyrighted article described in § 1.861–18(b)(1)(ii). The provision of the software constitutes a lease of a copyrighted article under § 1.861–18 because access to the app is terminated when the monthly fee is no longer paid, even though Corp B employees retain the locked files on their devices. See § 1.861–18(h)(4).

(6) *Example 6: Data storage, separate from access to offline software*—(i) *Facts.* The facts are the same as in paragraph (d)(5)(i) of this section (the facts in *Example 5*), except that Corp A also provides on-demand network data storage to Corp B on Corp A's servers in exchange for a monthly fee based on the amount of data storage used by Corp B. Under the data storage terms, Corp B employees may store files created by Corp B employees using Corp A's software or other software. Although Corp A's word processing software is compatible with Corp A's data storage systems, the core functionality of Corp A's software is not dependent on Corp B's purchase of the storage plan. Corp A's provision of software and data storage capacity constitute separate transactions.

(ii) *Analysis.* (A) As explained in paragraph (d)(5)(ii) of this section, Corp B's download of fully functional software, along with on-demand network access to certain limited online features, does not constitute a cloud transaction, but rather constitutes a lease of a copyrighted article under § 1.861–18.

(B) The provision of on-demand network data storage by Corp A to Corp B is a cloud transaction with one element. Therefore, the transaction is treated solely as a cloud transaction under paragraph (b) of this section and is classified as the provision of services under paragraph (c)(1) of this section.

(7) *Example 7: Streaming and temporary download of digital content using third-party servers*—(i) *Facts.* Corp A offers via stream or temporary download digital content in the form of videos and music to customers from servers located in data centers owned and operated by Data Center Operator. Each customer uses a computer or other electronic device to access unlimited streaming or temporary downloads of video and music in exchange for payment of a flat monthly fee to Corp A. The customer may select from among the available content the particular video or song to be streamed or downloaded. Corp A continually updates its content catalog, replacing content with higher quality versions and adding new content at no additional charge to the customer. It also provides additional functionality such as various methods of filtering and sorting the library, a watchlist, and recommendations based on a customer's preferences. Content that is streamed to the customer is not stored locally on the customer's computer or other electronic device and therefore can be played only while the customer's computer or other electronic device is connected to the internet. Content that is temporarily downloaded is stored on the customer's computer or other electronic device for 1 week and therefore can be played while the customer's computer or other electronic device is not connected to the internet. Corp A cannot reasonably ascertain the primary benefit or value that its specific customers derive from accessing Corp A's catalog of digital content. Data collected by Corp A indicates that the vast majority of customers stream digital content rather than temporarily download the content. Corp A pays Data Center Operator a fee based on the amount of data storage used and computing power made available in connection with Corp A's content offerings.

(ii) *Analysis.* (A) The provision of data storage and computing power by Data Center Operator to Corp A is a cloud transaction with one element. Therefore, the transaction is treated solely as a cloud transaction under paragraph (b) of this section, and is classified as the provision of services under paragraph (c)(1) of this section.

(B) A transaction between Corp A and a customer has two elements. One element is streaming access to a curated and routinely updated library of digital content, which would be a cloud transaction described in paragraph (b) of this section if considered separately. Another element is the transfer of a copy of digital content via temporary download, which would be a transfer of a copyrighted article under § 1.861–18(b)(1)(ii) if considered separately.

(C) Because the transaction has multiple elements, one or more of which would be a cloud transaction if considered separately, paragraph (c)(2) of this section provides that the transaction is classified as a cloud transaction if its predominant character is a cloud transaction. Pursuant to § 1.861–18(b)(3), the predominant character of the transaction is based on the primary benefit or value of the transaction to the customer if it is reasonably ascertainable. However, Corp A cannot reasonably ascertain the primary benefit or value derived by a specific customer from Corp A's offering. In such situations, § 1.861–18(b)(3)(ii) provides that the predominant character of a transaction may be determined based on the

primary benefit or value to a typical customer of a substantially similar transaction. This primary benefit or value to a typical customer can be identified through actual data about use or access pursuant to § 1.861–18(b)(3)(ii)(A), or if that data is not available, by using other evidence indicative of the primary benefit or value to a typical customer pursuant to § 1.861–18(b)(3)(ii)(B). Because Corp A has data that shows the typical customer streams digital content rather than temporarily downloading it, the primary benefit or value received by a typical customer is streaming access to digital content. Therefore, the predominant character of the transaction is a cloud transaction. Under paragraph (c)(1) of this section, the cloud transaction is classified as the provision of services.

(8) *Example 8: Access to online database*—(i) *Facts.* Corp A offers an online database of industry-specific materials. Customers access the materials through Corp A's website, which aggregates and organizes information topically and hosts a proprietary search engine. Corp A hosts the website and database on its own servers and provides multiple customers access to the website and database concurrently. Most materials in Corp A's database are publicly available by other means, but Corp A's website offers an efficient way to locate and obtain the information on demand. Certain materials in Corp A's database constitute digital content within the meaning of § 1.861–18(a)(2), and Corp A pays the copyright owners a license fee for using them. Each customer may download any of the materials to its own computer and keep such materials without further payment. The customer pays Corp A a fee based on the number of searches or the amount of time spent on the website, and such fee is not dependent on the amount of materials the customer downloads. The fee that the customer pays is substantially higher than the stand-alone charge for accessing the same digital content outside of Corp A's system. Corp A cannot reasonably ascertain the primary benefit or value that a specific customer derives from accessing Corp A's database. Corp A does not have data indicating whether the typical customer downloads materials from the database. Corp A markets its website and online database as user-friendly and an efficient way to find relevant materials because of its proprietary search engine. Developing the proprietary search engine was the largest cost Corp A incurred in creating its website and online database.

(ii) *Analysis.* (A) The transaction between Corp A and a customer has multiple elements. One element is Corp A's provision to a customer of access to Corp A's website and online database, which is a cloud transaction described in paragraph (b) of this section if considered separately. Another element is the transfer of digital content via download, which is the transfer of a copyrighted article under § 1.861–18 if considered separately.

(B) Because the transaction has multiple elements, one or more of which would be a cloud transaction if considered separately, paragraph (c)(2) of this section provides that the transaction is classified as a cloud transaction if its predominant character is a cloud transaction. Pursuant to § 1.861–18(b)(3), the predominant character of the transaction is based on the primary benefit or value of the transaction to the customer, if it is reasonably ascertainable. However, Corp A cannot reasonably ascertain the primary benefit or value derived by a specific customer from access to Corp A's database. In such situations, § 1.861–18(b)(3)(ii) provides that the predominant character of a transaction may be determined based on the primary benefit or value to a typical customer of a substantially similar transaction. This primary benefit or value to a typical customer can be identified through actual data about use or access pursuant to § 1.861–18(b)(3)(ii)(A), or if that data is not available, by using other evidence indicative of the primary benefit or value to a typical customer pursuant to § 1.861–18(b)(3)(ii)(B). That Corp A focuses on its proprietary search engine when marketing its website and database, as well as the facts that the search engine was the most expensive cost incurred by Corp A in creating its website and database, and that customers pay a substantially higher fee to access Corp A's system than they would otherwise pay to access the content outside of Corp A's system, indicates that the primary benefit or value received by a typical customer is the right to use the search engine. Therefore, under paragraph (c)(2) of this section, the predominant character of the transaction between Corp A and a customer is a cloud transaction. Under paragraph (c)(1) of this section the cloud transaction is classified as the provision of services.

(9) *Example 9: Temporary or perpetual access to a single movie via stream or download*—(i) *Facts.* Corp A hosts movies on its website and allows customers to view a single movie for a limited period or perpetually for a one-time fee, with perpetual viewing rights costing a higher fee. Corp A does not charge customers a separate fee for access to the website. In addition, Corp A's website provides recommendations for movies based on a customer's search for a particular title and/or the customer's purchase history. Customers have no ability to alter the servers, website, or movies available on the website. The movies in Corp A's database constitute digital content within the meaning of § 1.861–18(a)(2), and Corp A pays the copyright owners a license fee for using them. Corp A allows customers to view the movies by either streaming the movies from Corp A's servers, or by downloading the movies onto the customer's computer or other electronic device. The file size of movies offered by Corp A is generally large and so customers may be expected to download movies only in certain situations such as when traveling without internet access. Upon the expiration of the rental period, customers will no longer have access to stream the movies, and any movie that was downloaded onto a customer's computer or other electronic device will auto-delete from the customer's computer or other electronic device. Whether a customer chooses to view the movie via stream or download, Corp A charges the same one-time fee. Corp A cannot reasonably ascertain the primary benefit or value that a specific customer derives from accessing Corp A's website. Corp A maintains aggregate data on whether a given movie is viewed via stream or download, and this data shows that most movies are viewed by streaming, even in the case where a customer pays for the right to view a movie in perpetuity.

(ii) *Analysis.* (A) A transaction between Corp A and a customer contains multiple elements. One element is Corp A's provision to a customer of access to Corp A's website in order to view a movie via stream, which is a cloud transaction described in paragraph (b) of this section if considered separately. Another element is Corp A's provision to a customer of access to Corp A's website in order to download a movie, which is the transfer of a copyrighted article under § 1.861–18 if considered separately.

(B) Because the transaction has multiple elements, one or more of which would be a cloud transaction if considered separately, paragraph (c)(2) of this section provides that the transaction is classified as a cloud transaction if its predominant character is a cloud transaction. Pursuant to § 1.861–18(b)(3), the predominant character of the transaction is based on

the primary benefit or value of the transaction to the customer, if it is reasonably ascertainable. However, Corp A cannot reasonably ascertain the primary benefit or value derived by a specific customer from access to Corp A's database. In such situations, § 1.861–18(b)(3)(ii) provides that the predominant character of a transaction may be determined based on the primary benefit or value to a typical customer of a substantially similar transaction. This primary benefit or value to a typical customer can be identified through actual data about use or access pursuant to § 1.861–18(b)(3)(ii)(A), or if that data is not available, by using other evidence indicative of the primary benefit or value to a typical customer pursuant to § 1.861–18(b)(3)(ii)(B). Corp A has data that shows that the typical customer views movies by streaming rather than download. Accordingly, under paragraph (c)(2) of this section, the predominant character of the transaction is a cloud transaction because the primary benefit or value a typical customer receives is access to stream movies on Corp A's website. Under paragraph (c)(1) of this section, the cloud transaction is classified as the provision of services.

(10) *Example 10: Reseller of software as a service*—(i) *Facts.* Corp A owns the copyright to software (Program S). Corp A hosts Program S on its servers. Customers access Program S only through an internet connection. Corp A grants Corp B, a foreign corporation wholly owned by Corp A, the right to sell access to Program S to Corp B's customers that are located in Corp B's country. Corp B is responsible for managing the purchase/sale interaction with Corp B's customers, including invoicing and collections. Corp A is responsible for providing customers with access to Program S. Corp B does not perform any functions to provide access to Program S.

(ii) *Analysis.* (A) The transaction between Corp A and Corp B is treated as Corp A providing on-demand access to Program S to Corp B even though Corp B resells that access. This transaction is a cloud transaction with one element. Under paragraph (c)(1) of this section, the cloud transaction is classified as the provision of services. The transaction does not involve the transfer of any copyright rights described in § 1.861–18(c)(2), and therefore is governed solely by this section.

(B) The transaction between Corp B and its customers is the provision of on-demand access to Program S by Corp B, which is a cloud transaction with one element. Under paragraph (c)(1) of this section, the cloud transaction is classified as the provision of services. The transaction does not involve the transfer of any copyright rights described in § 1.861–18(c)(2), and therefore is governed solely by this section.

(11) *Example 11: Computer game with online functionality and in-game purchases*—(i) *Facts.* Corp A owns the copyright to a computer game (Game X). Customers can purchase Game X for a one-time fee and download it onto their computers. A customer may play certain aspects of Game X while not connected to the internet, but most of the core functionality of Game X is available only when the customer is connected to the internet, including the ability to play with other customers. In order to access the additional online functionality specific to Game X, customers must pay a monthly fee to Corp A. The additional functionality of Game X is hosted on servers owned by Corp A. Customers may also pay a one-time fee to access an in-game item that can be utilized only when playing Game X online.

(ii) *Analysis.* (A) There are three transactions between Corp A and a customer. The first transaction is the transfer of a copy of Game X, which is a digital content transaction with one element because a customer receives from Corp A access only to offline content in exchange for purchasing a copy of the game. Therefore, this transaction is treated solely as a transfer of a copyrighted article under § 1.861–18.

(B) The second transaction between Corp A and a customer is the payment of a monthly fee to play Game X online on Corp A's servers, which is a cloud transaction with one element. Therefore, this transaction is treated solely as a cloud transaction, and is classified as the provision of services under paragraph (c)(1) of this section.

(C) The third transaction between Corp A and a customer is the payment of a one-time fee in exchange for an in-game item. Because a customer can utilize the item only when playing Game X through an internet connection, the transaction is a cloud transaction with one element. Therefore, this transaction is treated solely as a cloud transaction, and is classified as the provision of services under paragraph (c)(1) of this section.

(e) *Applicability date*—(1) *In general.* This section applies to taxable years beginning on or after January 14, 2025.

(2) *Early application.* A taxpayer can apply this section to taxable years beginning on or after August 14, 2019 and all subsequent taxable years not described in paragraph (e)(1) (early application years) if—

(i) The taxpayer also applies § 1.861–18 to the early application years;

(ii) This section and § 1.861–18 are applied to the early application years by all persons related to the taxpayer (within the meaning of sections 267(b) and 707(b));

(iii) The period of limitations on assessment for each early application year of the taxpayer and all related parties (within the meaning of sections 267(b) and 707(b)) is open under section 6501; and

(iv) The taxpayer would not be required under this section to change its method of accounting as a result of such election.

(f) *Change in method of accounting required by this section.* In order to comply with this section, a taxpayer may be required to change its method of accounting. If so required, the taxpayer must secure the consent of the Commissioner in accordance with the requirements of § 1.446–1(e) and the applicable administrative procedures for obtaining the Commissioner's consent under section 446(e) for voluntary changes in methods of accounting.

§ 1.937–3 [Amended]

■ **Par. 5.** Section 1.937–3 is amended by removing *Examples 4* and *5* from paragraph (e).

Douglas W. O'Donnell,

Deputy Commissioner.

Approved: December 18, 2024.

Aviva R. Aron-Dine,

Deputy Assistant Secretary of the Treasury (Tax Policy).

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 301

[TD 10026]

RIN 1545–BQ72

Rules Regarding Certain Disregarded Payments and Dual Consolidated Losses

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final rule.

SUMMARY: This document contains final regulations regarding certain disregarded payments that give rise to deductions for foreign tax purposes and