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U.S. Tax Court: Taxpayer entitled to section 199 deductions

The U.S. Tax Court today held that the taxpayer was entitled to some, but not all, of the deductions under section 199 that it claimed in respect of two complex software products it developed.

The case is: *Bloomberg v. Commissioner*, T.C. Memo 2024-108 (December 11, 2024). Read the Tax Court's [opinion](#)

Summary

The taxpayer, a major financial technology, information, and news business, created an interactive financial information/analysis product that customers paid a subscription fee to use. The product was a combination of financial data, news, analytical and graphing software, and communication (email and instant messaging) features. The taxpayer's agreements with customers did not specify what portions of the subscription fees were attributable to the various product features. Software that enabled the product to function was hosted on the taxpayer's servers. Customers accessed that software by internet/private network connection, with only nominal software installed on their own hardware.

For the years at issue (2008–10), the taxpayer claimed deductions under section 199, and in calculating those deductions reported that substantial portions of the subscription fees (and related expenses) were allocable to product software. The taxpayer's position is that while the general rule is that provision of access to software is a service, the software at issue meets an exception to the general rule based on similar third-party software that was available to customers by disk or download under Treas. Reg. § 1.199-3(i)(6)(ii), (iii)(B).

The taxpayer also created a second product that helped customers keep track of their transactions and investments. This product required a subscription to the first product to operate, though it had separate customer agreements and a separate subscription fee. Software that enabled the second product to function was hosted on the taxpayer's servers. Customers accessed the software by internet/private network connection rather than by installing the software on their own hardware.

With respect to the second product, the taxpayer claims that (1) most subscription fees (and related expenses) were allocable to product software, and (2) the software at issue also meets an exception to the rule that the provision of access to software is a service based on similar third-party software that was available to customers by disk or download under Treas. Reg. § 1.199-3(i)(6)(ii), (iii)(B).

The IRS disallowed the taxpayer's claimed section 199 deductions, taking the position that none of the taxpayer's gross receipts were derived from the provision of access to software and all of the taxpayer's gross receipts were derived from the provision of other services. The IRS also argued that the taxpayer did not meet other requirements of the Treas. Reg. § 1.199-3(i)(6)(iii)(B) exception to the general rule that the provision of access to software constitutes a service. Alternatively, the IRS argued that the taxpayer's allocation of gross receipts (and related expenses) between software and services was incorrect.

The Tax Court held with respect to the first product that the taxpayer derived gross receipts from the provision of access to analytical and graphing software, and not from the provision of other services. The court found that nothing in Treas. Reg. § 1.199-3(i)(6)(iii) provides that software cannot operate in conjunction with other services, and Treas. Reg. § 1.199-3(i)(6)(iii)(B) requires only that one derive gross receipts from the disposition of software. The court further found that such analytical and graphing software met the requirements of Treas. Reg. § 1.199-3(i)(6)(iii)(B). The court also held with respect to the second product that the taxpayer mostly derived gross receipts from the provision of access to software, and that such software met the requirements of Treas. Reg. § 1.199-3(i)(6)(iii)(B).

The court stated that it generally found Treas. Reg. § 1.199-3 to be ambiguous with respect to many of the questions presented in the case, but it generally rejected the IRS' interpretation, which it stated would eliminate favorable treatment under section 199 for all of the taxpayer's software, and indeed almost any complex software—a result that cannot be reconciled with the statute.

The court found, however, that the taxpayer allocation of gross receipts (and related expenses) between software and services was unreasonable and incorrect.

In sum, the taxpayer reported gross receipts qualifying as domestic production gross receipts for purposes of section 199 of \$2.121 billion for 2008, \$1.773 billion for 2009, and \$4.077 billion for 2010, and reported allocable expenses for purposes of computing section 199 deductions of \$1.377 billion for 2008, \$1.002 billion for 2009, and \$2.084 billion for 2010. The Tax Court held that the taxpayer had domestic production gross receipts for purposes of section 199 of \$1.293 billion for 2008, \$1.366 billion for 2009, and \$1.465 billion for 2010, and that the taxpayer's expenses allocable to such receipts were \$769 million for 2008, \$799 million for 2009, and \$887 million for 2010.

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