



TaxNewsFlash

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Final and proposed regulations: Classification of digital content and cloud transactions for purposes of international provisions of the Code

The U.S. Treasury Department and IRS (collectively, Treasury) today released final regulations relating to the classification of digital content and cloud transactions for purposes of the international provisions of the Code. Treasury also released proposed regulations related to the source of income from cloud transactions.

- The [final regulations](#) (T.D. 10022) modify the rules under existing Treas. Reg. § 1.861-18 for classifying transactions involving computer programs, including by applying the rules to transfers of digital content, and provide rules for the classification of transactions involving on-demand network access to computing and other similar resources (cloud transactions).
 - The final regulations retain the overall approach of the proposed regulations issued in August 2019 (the 2019 proposed regulations).
 - Although the 2019 proposed regulations were proposed to apply to transactions entered into pursuant to contracts entered into in tax years beginning on or after the date the regulations were finalized, the final regulations generally apply to tax years beginning on or after the date the final regulations are published in the Federal Register, which is scheduled to be January 14, 2025. However, taxpayers may elect to apply all of the rules of the final regulations to tax years beginning on or after August 14, 2019, and all subsequent tax 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 tax years beginning on or after August 14, 2019, and all subsequent taxable years, the period of limitations on assessment for each tax year of the taxpayer and all related parties 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.
- The [proposed regulations](#) (REG-107420-24) provide rules for determining the source of income from cloud transactions.
 - The proposed regulations state that gross income from a cloud transaction is sourced as services income under section 861(a)(3) or 862(a)(3), as appropriate, according to where the service is

performed. The place of performance of a cloud transaction is established through a formula composed of a fraction that relies on three factors: the intangible property factor, the personnel factor, and the tangible property factor. Importantly, the proposed regulations generally look only to the assets and personnel of the relevant taxpayer or entity, rather than to the assets and personnel of related persons, though Treasury continues to study that issue.

- The proposed regulations are proposed to apply to tax years beginning on or after the date the proposed regulations are finalized.
- Comments on the proposed regulations and requests for a public hearing are due by the date that is 90 days after the date the proposed regulations are published in the Federal Register, which is scheduled to be January 14, 2025.

Notice 2025-6

Treasury today also issued [Notice 2025-6](#) requesting comments on any potential implications if the characterization rules contained in Treas. Reg. §§ 1.861-18 and 1.861-19, as amended and added, respectively, by the final regulations, were to apply to all provisions of the Code, including the need for additional guidance, and seeks specific comments on the possible impacts and guidance that may be necessary with respect to certain identified provisions.

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