



US International Tax Alert

Final digital content and cloud transaction regulations issued

On January 14, 2025, the Treasury Department and the IRS published final regulations ([TD 10022](#)) to finalize proposed regulations issued on August 14, 2019 ([REG-130700-14](#)) (the “2019 Proposed Regulations”), addressing the classification of transactions involving digital content and cloud transactions. These final regulations refine the existing rules under Treas. Reg. § 1.861-18 for digital content and introduce new rules under Treas. Reg. § 1.861-19 for cloud transactions. The final regulations closely follow the framework established in the 2019 Proposed Regulations, with some updates and clarifications.

The final regulations apply to taxable years beginning on or after the date of publication in the Federal Register (January 14, 2025). Taxpayers may elect early application for taxable years beginning on or after August 14, 2019, if certain conditions are met.

General framework

The final regulations maintain the structure of the 2019 Proposed Regulations, which extended the classification rules under Treas. Reg. § 1.861-18 to encompass “digital content” transactions beyond computer programs and established new rules under Treas. Reg. § 1.861-19 for “cloud transactions.” Digital content means a computer program or any other content, such as books, movies, and music, in digital format that is protected by copyright law or no longer so protected solely due to the passage of time or because the creator dedicated the content to the public domain. A cloud transaction is a transaction through which a person obtains on-demand network access to computer hardware, digital content, 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. The final regulations retain the categories of transactions involving digital content, specifically transfers of copyright rights and copyrighted articles, the provision of services, and the provision of know-how.

Highlights

Predominant character rule:

- The predominant character rule replaces the “de minimis” rule in current Treas. Reg. § 1.861-18(b)(2) with a predominant character rule for digital content transactions, consistent with the subpart F regulations under Treas. Reg. § 1.954-1(e)(3).

- Treas. Reg. § 1.861-19(c)(2) of the final regulations provides a similar rule for transactions, one or more elements of which is a cloud transaction.
- A transaction generally is classified under the predominant character rule based on the primary benefit or value received by the customer. Special rules are provided for cases when such information is not reasonably ascertainable by the income recipient.

Scope of Treas. Reg. § 1.861-18:

- Consistent with the 2019 Proposed Regulations, the final regulations confirm that Treas. Reg. § 1.861-18 applies to all digital content transactions, including transfers of non-software digital content.
- The final regulations explain that the definition of digital content does not extend beyond content protectable by copyright law. For example, non-copyrightable content such as raw data does not constitute digital content. However, the regulation specifically includes content that is no longer protected by copyright law solely due to the passage of time or because the creator dedicated it to the public domain.

Cloud transactions treated solely as services:

- All cloud transactions are characterized as services, removing the prior services v. lease factors-based test that was included in the 2019 Proposed Regulations.

Source of income for digital content sales:

- The final rules move away from both the title passage (prior law) and place of download approaches (2019 Proposed Regulations) for sales of copyrighted articles delivered electronically. Instead, sales are sourced to the billing address of the purchaser, which may materially change the sourcing analysis between the proposed and final regulations.
- The final regulations confirm section 863(b) must be applied when the taxpayer “produces” the digital content/software program; however, it provides no guidance on the functions of which “production” consists and the relevant assets.
- An anti-abuse provision is added to address potential tax-avoidance arrangements.

Illustrative examples:

- Numerous examples are added and revised to clarify the application of the rules (including predominant character) to common business models, including scenarios involving video games, streaming services, and platform operators.

Elective early application:

- Although the final regulations generally apply prospectively, taxpayers may elect to apply these regulations to taxable years beginning on or after August 14, 2019, provided they consistently apply the rules (both Treas. Reg. §§ 1.861-18 and -19) and satisfy certain procedural requirements.

- Of note, the final regulations eliminated the grandfather rule in the 2019 Proposed Regulations relating to digital content (see Prop. Treas. Reg. § 1.861-18(i)). That rule provided that contracts entered into in taxable years beginning before the date of publication of final regulations in the Federal Register would continue to be governed by the pre-existing regulations under Treas. Reg. § 1.861-18 (including the title passage sourcing rule for sales of copyrighted articles).

Additional guidance

- The IRS also issued [Notice 2025-6](#) on January 10, 2025, seeking comments on the potential impact of extending the characterization rules outlined in Treas. Reg. §§ 1.861-18 and -19 to all provisions of the Internal Revenue Code. Stakeholders are invited to submit their comments electronically or by mail within 90 days of the Notice's publication in the Internal Revenue Bulletin.
 - The Notice request feedback on areas that could be affected, examples of specific implications, and recommendations for any additional guidance needed.
- IRS and Treasury also issued proposed regulations ([REG-107420-24](#)) (the "Proposed Cloud Transaction Sourcing Rules") under Treas. Reg. § 1.861-19(d) that provide specific rules for determining the source of income from cloud transactions for purposes of the international provisions of the Internal Revenue Code. These proposed regulations will be covered in a separate US International Tax Alert (see [archive on deloitte.com](#)).

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