

NY proposes sourcing regs for services, other business receipts, and digital products

Overview

The New York State Department of Taxation and Finance (Department) recently proposed regulations that would amend 20 NY Codes, Rules and Regulations Section 4-4.6 (“Receipts from Other Services and Other Business Activities”) and add new Section 4-4.9 (“Receipts from Sales of Digital Products”).¹ These regulations address the sourcing of receipts from other services and other business activities and sales of digital products that are currently governed by the hierarchies described in Tax Law Sec. 210-A.10 (for other services and other business activities) and 210-A.4 (for digital products), respectively.² These proposed regulations are part of a broader effort by the Department “to amend the Article 9-A Business Corporation Franchise Tax Regulations to incorporate the changes made by the corporate tax reform legislation contained in the 2014-2015 and 2015-2016 enacted New York State Budgets.”³

This Tax Alert summarizes the two proposed regulations and then offers some general thoughts regarding how the various examples included in the regulations provide clarity while in some instances may create uncertainty or ambiguity. Taxpayers may wish to consider whether the regulations and related examples could benefit from further clarification, keeping in mind that the deadline for submitting public comment on these regulations is January 16, 2016.

General principles for receipts from other services and other business activities and digital products

The proposed regulations for sourcing receipts from other services and other business activities and digital products are in many respects similar. Notable similar elements of the two proposed regulations include the following:

- Proposed Reg. Secs. 4-4.6(a)(1) and 4-4.9(a)(1) both provide that the various sourcing rules would “apply sequentially in a hierarchy.” Before a taxpayer can move to the next step of the hierarchy, it must annually exercise due diligence by applying several standards. As a general matter, the proposed regulations state that “[a] taxpayer’s method of sourcing its receipts, including the use of a method of approximation where applicable, must reflect an attempt to obtain the most accurate sourcing of receipts consistent with the regulatory standards set forth herein rather than an attempt to minimize the taxpayer’s tax liability.”
- While Tax Law Secs. 210-A.10 and 210-A.4 each generally require due diligence in applying the sourcing hierarchy, Proposed Reg. Secs. 4-4.6(a)(2)(iv) and 4-4.9(a)(2)(iv) would require taxpayers that are unable to apply a level of the hierarchy (after attempting to satisfy the preferred sourcing method, which, for receipts from other services and other business activities, is where the benefit is received; and for receipts from digital products, is the primary use location) to document the steps taken before abandoning a level of the hierarchy.
 - As part of exercising due diligence, taxpayers must maintain contemporaneous records explaining “the determination and application of its method of sourcing its receipts,” and be able to provide this documentation for audit upon request.⁴
 - Moreover, Proposed Reg. Secs. 4-4.6(a)(2)(iv) and 4-4.9(a)(2)(iv) state that “[w]hen abandoning a level of the hierarchy, the standard of due diligence is not satisfied if a taxpayer merely relies on the fact that its existing systems of recording transactions or the current format of its books and records do not capture the information required.” The Department has informally stated that a taxpayer should examine its existing systems and, if necessary, determine the feasibility of modifying its current system or putting a new system in place. A taxpayer would have to document its determination that it would be too costly to modify its systems to capture the necessary information before satisfying the due diligence requirement and abandoning a level of the hierarchy.

¹ Proposed Regulation Section 4-4.6 (“[Receipts from Other Services and Other Business Activities](#)”) and Proposed Regulation Section 4-4.9 (“[Receipts from Sales of Digital Products](#)”).

² The sourcing of other types of receipts (e.g., receipts from financial transactions) may be covered under other sections of New York Tax Law Sec. 210-A. Accordingly, receipts properly sourced under other sections would not be addressed under these proposed regulations.

³ “[Corporate tax reform draft regulations](#),” *New York State Department of Taxation and Finance*, Oct. 16, 2015.

⁴ Proposed Reg. Secs. 4-4.6(a)(2)(iii) and 4-4.9(a)(2)(iii).

- At any point in the hierarchy where there is a presumption, Proposed Reg. Secs. 4-4.6(a)(3) and 4-4.9(a)(3) would each provide a way for taxpayers and the Department to overcome the presumption. Taxpayers intending to overcome a presumption would be required to show by a preponderance of the evidence that the method they are proposing to use is a more accurate method of sourcing receipts under the applicable rule of the hierarchy. Conversely, to overcome a presumption the Department would be required to show, by a preponderance of the evidence, that: (1) the presumption fails to accurately source receipts under the applicable rule of the hierarchy; and (2) the taxpayer had access to, or could have obtained upon reasonable inquiries, information that would have made the sourcing of their receipts more accurate.
- When receipts from a service or other business activity are commingled with either receipts from tangible personal property or receipts from digital products, it appears (except where the tangible personal property or digital product is incidental to the service or other business activity) that the overall receipt sourcing would be determined by the rules established for sourcing receipts from tangible personal property or receipts from digital products, as the case may be.
 - For example, Proposed Reg. Sec. 4-4.6(a)(4) provides that when a single receipt includes a service or other business receipt and tangible personal property, generally the entire receipt would be sourced as tangible personal property under Tax Law Sec. 210-A(2)(a). This is in contrast to 20 NYCRR Sec. 4-4.1(c), promulgated under pre-2015 law, which states that for sourcing purposes, an allocation must be made on a reasonable basis if a taxpayer receives a lump sum in payment for services (which would be sourced as services) and for materials or other property (which would be sourced as sales of tangible personal property).
 - Similarly, Proposed Reg. Secs. 4-4.6(a)(4)(ii) and 4-4.9(4)(iii) provide that when a single receipt includes a service or other business receipt and a digital product, generally the entire receipt would be sourced as a digital product under Tax Law Sec. 210-A(4).
 - Finally, when a sale includes both tangible personal property and a digital product commingled into one receipt, generally the entire receipt would be sourced as tangible personal property under the rules for Tax Law Sec. 210-A(2)(a).
- Proposed Reg. Secs. 4-4.6(g) and 4-4.9(g) would each provide special rules for transactions involving an “intermediary,” which is defined under Proposed Reg. Secs. 4-4.6(b)(6) and 4-4.9(b)(6) as “a business customer of a taxpayer that indicates, as part of its contract or other agreement with the taxpayer, that the service or other business activity [or digital product] will be primarily utilized by a consumer.” The proposed regulations would provide sourcing methods for (1) transactions in which taxpayers provide services directly to consumers “on behalf of” an intermediary, and (2) transactions in which taxpayers provide products or services to consumers “through” an intermediary.
 - For both types of intermediary transactions, sales would be sourced to the ultimate consumer instead of the intermediary.

The Department noted through examples that in some circumstances that may appear to include an intermediary, the product/service would be treated as delivered/complete upon delivery to the would-be intermediary. In those examples, the Department does not think the product/service is provided to the ultimate consumers on behalf of or through the intermediary. [See discussion of Examples #20 and #21 below - Selected examples from Proposed Reg. Sec. 4-4.6 (“Receipts from Other Services and Other Business Activities”)].
 - For both types of intermediary transactions, if, after exercising due diligence, a taxpayer is unable to obtain adequate information to source to the ultimate consumer, the proposed regulations generally would permit the transactions to be sourced to the intermediary.

Sourcing services and other business receipts

- A taxpayer must source services and other business receipts according to the following hierarchy:
 1. The location where the customer receives the benefit of the service;
 2. Where the service is delivered;
 3. According to the apportionment fraction for the preceding taxable year; or
 4. According to the apportionment fraction for the current taxable year.⁵

⁵ New York Tax Law Sec. 210-A.10(b).

- Under Proposed Reg. Sec. 4-4.6(c), the location where the customer receives the benefit of the service would be “where the customer derives the value from a service or other business activity purchased from the taxpayer.” Other than services performed in-person or services related to real property, this determination would depend on whether the customer is an individual or a business.
 - The benefit of a service for individual customers would be presumed to be the individual’s billing address. If the taxpayer does not have the billing address in its records, it would not be required to make reasonable inquiries to the customer.
 - The benefit of a service for business customers would be “presumed to be received in New York State to the extent the contract between the taxpayer and the taxpayer’s customer, or the taxpayer’s books and records kept in the normal course of business, ... indicate the benefit of the service is in New York State.” In contrast to individual customers, if a taxpayer does not have this information, it would be required to make reasonable inquiries with the customer.
 - If the benefit of a service is received both in New York and another state, taxpayers would apportion “the receipts based on the value derived by the customer in each location where benefit is received as a percentage of the total value derived by the customer.”
 - When a taxpayer is unable to determine the location where the benefit is received, a taxpayer would be permitted to reasonably approximate the location.
 - To be eligible to reasonably approximate the location, a taxpayer must not be able to determine the location where the benefit is received, or obtaining such location would require undue effort and expense;⁶ and the taxpayer must have “sufficient information to reasonably approximate the location or locations where the benefit is received.”
 - Importantly, a taxpayer would not be able to use census data when making a reasonable approximation.
 - In-person services would be sourced according to whether the service is rendered (a) to the body or in the physical presence of an individual, or (b) on the tangible personal property of a customer. When services are rendered to the body or in the presence of an individual in New York, they would be sourced to New York. When the service is performed on tangible personal property, receipts would be presumed to be sourced to the location where the customer receives the property after the service is performed.
 - While professional services like medical and dental services would follow these special rules, other professional services where significant in-person contact is not required to be performed—such as legal, accounting, and consulting services—would follow the regular sourcing rules for other services.
 - The benefit of services related to real property would be received in New York where the real property is located in New York.
- Under Proposed Reg. Sec. 4-4.6(d), if the location where the customer receives the benefit of the service cannot be determined after exercising due diligence, taxpayers would be able to source according to where the service was delivered to the customer.
 - For individual customers, this determination would be based on the evidence available to the taxpayer, such as sales records.
 - For business customers, this location would be “presumed to be the location at which the contract of sale is managed by the customer.” If this location cannot be determined, the taxpayer would be able to use the billing address of the customer.
- Under Proposed Reg. Sec. 4-4.6(e), if the location where the benefit was received or the location where the services were delivered cannot be determined, services would be sourced according to the sales factor from such services for the preceding year to the extent that the factors that produced the preceding year’s fraction remain substantially similar to the current year.
 - This rule cannot be applied to a taxpayer’s first taxable year beginning on or after January 1, 2015, presumably to prevent the importation of sourcing methods authorized under the prior statutory scheme. Further, new taxpayers are not permitted to use this method in their first taxable year as no relevant prior-year data would be available. In both cases, taxpayers must by-pass this rule and go directly to the method described in subdivision (f).

⁶ Undue effort and expense is described as “beyond the standard amount of due diligence required” for a taxpayer to abandon a level of the hierarchy. Proposed Reg. Sec. 4-4.6(c)(1)(iv)(A)(i)(ii).

- Under Proposed Reg. Sec. 4-4.6(f), if the taxpayer cannot determine or utilize the methods described in the higher levels of the hierarchy discussed above, services would be sourced according to the sales factor from the current year for all receipts that can be sourced using the methods prescribed in subdivisions (c) and (d).

Sourcing digital products

- Under Proposed Reg. Sec 4-4.9(b)(8), a “digital product” would be defined in part as:
 - “Any property or service, or combination thereof, of whatever nature delivered to the customer, or the consumer on behalf of or through an intermediary, through the use of wire, cable, fiber-optic, laser, microwave, radio wave, satellite or similar successor media, or any combination thereof. Digital product also includes, but is not limited to, an audio work, audiovisual work, visual work, book or literary work, graphic work, electronic database, game, information or entertainment service, storage of digital products and computer software by whatever means delivered.”
- A taxpayer must source digital products according to the following hierarchy:
 1. The location where the digital product is primarily used;
 2. Where the digital product is received;
 3. According to the apportionment fraction for the preceding taxable year; or
 4. According to the apportionment fraction for the current taxable year.⁷
- Under Proposed Reg. Sec. 4-4.9(c), the location where a digital product is primarily used would be “where the customer derives the value from the digital product purchased from the taxpayer.”
 - For individual customers, this location would be presumed to be the customer’s billing address. If the taxpayer does not have the customer’s billing address, it would not be required to make reasonable inquiries to the customer.
 - For business customers, “the primary use location” would be presumed to be in New York State “to the extent the contract between the taxpayer and the taxpayer’s customer, or the taxpayer’s books and records kept in the normal course of business ... indicate use of the digital product is in New York State.” For business customers, this determination would be made without regard for the business’s billing address. In contrast to the rule for individuals, if the taxpayer cannot determine the location of primary use for business customers, it would be required to make reasonable inquiries to the customers.
 - If a digital product is used both in New York and another state, taxpayers would apportion “the receipts based on the value derived by the customer in each primary use location as a percentage of the total value derived by the customer.”
 - When a taxpayer is unable to determine the location or locations of primary use, a taxpayer would be permitted to reasonably approximate the location.
 - To be eligible to reasonably approximate the location, a taxpayer must not be able to determine the location of primary use, or obtaining such location would require undue effort and expense; and the taxpayer must have “sufficient information to reasonably approximate the location or locations where the digital product is primarily used.”
 - As with sourcing services and other business receipts, a taxpayer would not be able to use census data when making a reasonable approximation.
- Under Proposed Reg. Sec. 4-4.9(d), if the location of primary use cannot be determined in line with the standard of due diligence, taxpayers would then source to where the digital product is received by the customer.
 - For individual customers, this would be “determined based on evidence available to the taxpayer,” and would include sales records and IP addresses.
 - For business customers, this “is presumed to be the location at which the contract of sale is managed by the customer.” If this cannot be determined, the location would be presumed to be the billing address of the customer.
- Under Proposed Reg. Sec. 4-4.9(e), if the primary use location or the location where the product is received cannot be determined, digital products would be sourced according to the sales factor from such services for

⁷ New York Tax Law Sec. 210-A.4(c).

the preceding year to the extent that the factors that produced the preceding year's fraction remain substantially similar to the current year.

- This rule cannot be applied to a taxpayer's first taxable year beginning on or after January 1, 2015, presumably to prevent the importation of sourcing methods authorized under the prior statutory scheme. Further, new taxpayers are not permitted to use this method in their first taxable year as no relevant prior-year data would be available. In both cases, taxpayers must by-pass this rule and go directly to the method described in subdivision (f).
- Under Proposed Reg. Sec. 4-4.9(f), if the taxpayer cannot determine or utilize the methods described in the higher levels of the hierarchy discussed above, digital products would be sourced according to the sales factor from the current year for all receipts that can be sourced using the methods prescribed in subdivisions (c) and (d).

Examples

The proposed regulations include numerous examples, many of which are highly fact-specific, potentially raising challenges for taxpayers seeking to apply them to other situations.

Selected examples from Proposed Reg. Sec. 4-4.6 ("Receipts from Other Services and Other Business Activities")

- In Example #1, the contract between Travel Support Corp (TSC) and its individual customers provides for a fee per call. TSC's call center is located in New York. While books and records indicate that 15 percent of customer billing addresses are in New York, additional books and records information indicates that only 7 percent of calls originate in New York. Example #1 states that because TSC's books and records show where the benefit of the services is actually received based on the origination location of the calls, TSC would be able to overcome the billing address presumption by using its books and records to source to New York 7 percent of its receipts from the support services provided by the call center.
- Example #2 contains the same facts except the contract between TSC and its customers provides for a set monthly fee, regardless of whether the customer makes any calls for travel support. Example #2 states that "[b]ecause each customer pays the same amount regardless of usage, and 15% of [TSC's] customers are located in New York State, the fact that only 7% of the calls originate from New York does not overcome the presumption that the benefit of the services is received at the billing addresses of the individual customers because this additional information is not relevant to the determination of where the benefit is received by its customers. This is because the charges are not based on a per call basis but rather on a flat monthly fee." Therefore, in Example #2, TSC would be required to source to New York 15 percent of its receipts from the support services provided by the call center.
 - It would appear in Example #2 that the Department is distinguishing when to apply the presumption that the benefit is received by individual customers at their billing address based on the price structure applied in the contract. The reason for such distinction is not clear, since, as noted above, under Proposed Reg. Sec. 4-4.6(c), the location where the customer receives the benefit of the service would be "where the customer derives the value from a service or other business activity purchased from the taxpayer."
- Examples #16 and #17 describe intermediary transactions involving a call center. In both examples, Answer Corp is a corporation that operates call centers in multiple states, including New York, and facilitates mail order sales from unrelated businesses. In Example #16, Retail Corp sells tangible property through its retail stores located in New York and other states, and through a mail order catalog. Retail Corp contracts with Answer Corp to answer telephone calls from individuals placing orders for products found in Retail Corp's catalog. Answer Corp charges Retail Corp a flat fee for its services. The Department states that "[t]he benefit of this service is received at the location of these consumers (Retail Corp's customers), which is determined when Answer Corp asks the consumers for their billing information, including billing address."
- Example #17 has the same facts, but states that 95 percent of Answer Corp's calls are for product sales and 5 percent are for product inquiries. Example #17 states that 95 percent of the flat fee would be sourced based on billing addresses and 5 percent based on the location of the call of the product inquiry.
 - Under this example, Answer Corp would source its receipts (a flat fee as in Example #2) to New York based on calls it receives for product orders and product inquiries. The fee for product orders would be sourced to New York based on customers with New York billing addresses, consistent with Example #2. The fee for product inquiries would be sourced based on call origination information (area code or billing address) consistent with Example #1. The reason for such distinction is not clear, since, as noted above, under Proposed Reg. Sec. 4-4.6(c), the location where the customer receives the benefit of the service would be "where the customer derives the value from a service or other business activity purchased from

the taxpayer.” These examples suggest that the location of the benefit with regard to Answer Corp’s service may be different when (a) a customer (who is not calling from the location of his or her billing address) calls to ask about sizing of a garment; and (b) the same customer calls, seconds later, to order the garment.

- In Example #3, Audit Corp is located in New York and provides accounting services for Client Corp. The contract between Audit Corp and Client Corp provides that Audit Corp is to audit Client Corp for a given year. Since Client Corp’s books and records, internal controls, and assets, are located in States A, B, and New York, Audit Corp’s staff will perform the audit in those locations. Audit Corp’s books and records track hours worked by employee per location. Example #3 states that the benefit of Audit Corp’s service is received in New York and States A and B based on Audit Corp’s time spent by each staff member in each location (per Audit Corp’s records). Audit Corp would source its receipts from auditing Client Corp to New York based on the time spent by Audit Corp employees on Client Corp’s audit within New York.
 - Here, determination of where the benefit of the audit was received to Client Corp would be based on the service provider’s hours, which appears to be more like a proportional cost of performance method. It would seem that using service provider hours for sourcing may not, in all cases, reflect “where the customer derives the value from a service or other business activity purchased from the taxpayer,” as set forth in Proposed Reg. Sec. 4-4.6(c).
- In Example #4, Payroll Corp (located in State A) contracts with Customer Corp to provide all payroll services to Customer Corp’s employees in New York and in other states. While the contract does not specify where the benefit of the service will be received, Payroll Corp’s books and records indicate the number of Customer Corp employees in each state. The Department states that the benefit of Payroll Corp’s services is received in all the states where Customer Corp has employees. As such, Payroll Corp would source its receipts to New York State based on Customer Corp’s New York employees.
- Conversely, in Example #19, Rating Corp has a contract with Credit Card Corp to assist in reviewing credit card applications. Credit Card Corp receives all credit rating services at its corporate office in State A where it makes credit card determinations. Applicants from many states send applications to Credit Card Corp, which provides information to Rating Corp. Credit Card Corp uses Rating Corp’s service to make a determination as to whether or not Credit Card Corp will issue the applicant a credit card. The Department notes that this is not an intermediary transaction because the service is provided directly to Credit Card Corp and is not passed on to the applicant. Because Credit Card Corp utilizes the service entirely in State A where it makes credit rating determinations, the entire receipt would be sourced to State A.
 - It is not clear why the facts in Examples #4 and #19 result in different sourcing. It would appear that Customer Corp in Example #4 is responsible for attending to payroll administration (as its employees presumably are entitled to be paid). Based on the reasoning in Example #19, it is possible that the benefit of Payroll Corp’s service is received at the location of Customer Corp’s corporate office, and not based on employees per state, because Customer Corp’s payroll administration would take place at the corporate office.
- In Example #6, Computer Corp is a computer repair corporation with retail locations in multiple states. Customer visits Computer Corp’s New York location to have a computer’s hardware repaired, and the repair work is performed at this New York location. Since the repair is completed on Customer’s computer, which is tangible personal property, it is considered an in-person service. If Customer takes back possession of the computer in New York, the benefit is received in New York and the receipts for the repair work would be sourced to New York. If Customer requests that the repaired computer be shipped to his or her home address in State A, the benefit is received in State A and the receipts for the repair work would be sourced to State A.
 - While this example is consistent with the proposed regulation regarding services rendered on tangible personal property of a customer, the outcome appears to be based on the delivery method chosen by Customer and not necessarily consistent with the general rule that the benefit is received by the customer “where the customer derives the value from a service or other business activity purchased from the taxpayer,” as set forth in Proposed Reg. Sec. 4-4.6(c). This is because the regulation has a presumption that a customer receives the benefit at the location where the customer receives the property after the service is performed.
- In Example #9, Law Corp, located in State C, is hired by Client Corp to handle a major litigation matter concerning the sale of its manufacturing plant located in New York. Client Corp has manufacturing plants in New York and State B. The trial takes place in State C. Because Law Corp’s entire service is related to the

manufacturing plant, which is real property, the benefit would be received by Client Corp at the location of the manufacturing plant in New York.

- Legal services related to litigation concerning the sale of a manufacturing plant are not as obviously “services related to real property” as, for example, pest control services, which are highlighted in Example #8; or engineering services related to on-site construction, which are highlighted in Example #7.
- In Example #20, Production Corp is hired by Cable Network Corp, located in New York, to produce a made-for-television movie. Production Corp will produce the television program and deliver it to Cable Network Corp, which will then air the program to subscribers. The Department states that this is not an intermediary transaction because the service is not provided on behalf of or through Cable Network Corp. Instead, the Department says the service “is completed prior to Cable Network Corp. passing it along to subscribers.” The example states that Production Corp’s contract with Cable Network Corp, and its books and records, indicate that Cable Network Corp receives the benefit of the service in New York; therefore the entire receipt would be sourced to New York.
 - It is not clear how Production Corp’s contract with Cable Network Corp, and its books and records, indicate that Cable Network Corp receives the benefit of the service in New York.
- Example #21 is similar. Broker Corp, located in State A, sells health insurance policies to large corporations, including Business Corp, for the benefit of those corporations’ employees. Business Corp is headquartered in State A, but has offices and employees in New York, as well as many other states. Business Corp pays Broker Corp a finder’s fee for finding a health insurance policy for Business Corp. This is not considered an intermediary transaction because the service is not provided on behalf of or through Business Corp. In this instance, the service is completed prior to Business Corp passing it along to employees. Therefore, Broker Corp would source the receipt based on where Business Corp receives the benefit. The example states that Broker Corp’s contract with Business Corp, and its books and records, indicate Business Corp will receive the benefit at all of its locations, which are relatively equal in size, including one that is located in New York. In the absence of any better information, Broker Corp would source the finder’s fee based on number of Business Corp’s offices in New York.
 - Here again, it is not clear how a contract or books and records may indicate where a customer receives the benefit of a particular service. In addition, it would seem that using the number of offices may not, in all cases, reflect “where the customer derives the value from a service or other business activity purchased from the taxpayer,” as set forth in Proposed Reg. Sec. 4-4.6(c), since the retention of high-valued employees located in a single area might indicate that the Business Corp is receiving more value in a single office.

Selected examples from Proposed Reg. Sec. 4-4.9 (Receipts from Sales of Digital Products)

- In Example #2, Software Corp sells accounting software through its website to individuals who have the option to download it directly onto their computer, or to receive the software on a disk shipped to their address. Customer A purchases the software and opts to have it shipped to her billing address in New York. Software Corp ships a box to Customer A that contains the software on a disc and a user manual. The Department states that “[c]omputer software by whatever means delivered is considered to be a digital product and therefore receipts from the software are sourced under these rules.” While the sale of the software to Customer A includes tangible personal property (the user manual), such property is deemed to be incidental to the actual sale of the software, and therefore the entire receipt would be sourced as a digital product.
 - Since the primary use location for an individual customer is presumed to be such customer’s billing address, Example #2 states that Software Corp would source the receipt to New York, the location of Customer A’s billing address.
- Consistent with Example #2, Example #10 describes a sale of software by a New York brick-and-mortar retailer. Sales are made to individual customers with cash or a credit card. For credit card purchasers, billing address information would be used to determine the primary use location for customers who are individuals because there is a presumption that the primary use location for individuals is the billing address. However, cash sales would be sourced to New York because the retailer is unable to gather sufficient evidence to reasonably approximate the primary use location.
 - This example highlights that all sellers (including brick-and-mortar retailers) of digital products would be required to source receipts from such products under the rules for sourcing sales of digital products.
- Examples #15 and #16 illustrate the Department’s interpretation of an intermediary transaction involving digital products. In Example #15, Database Corp, based in State C, develops an Internet-based information database

and enters into a contract with Retail Corp (the intermediary), whereby Retail Corp will market and sell access to this database to consumers. Although Database Corp does not have active involvement with its consumers and is paid by Retail Corp, Database Corp actively maintains and updates the database for the benefit of the consumers. As a result, Database Corp would be required to source its receipts to New York to the extent that consumers have billing addresses (obtained through Retail Corp) located in New York.

- In Example #16, Research Corp, located in State D, compiles a digital collection of treatises on a variety of subjects and sells a copy of its collection to University Corp, located in New York, which will provide access to the digital collection to all enrolled students. Research Corp does not provide continuing support for the digital collection after its sale; any update of information would be treated as a separate product. The Department states that “[f]or this reason, although the ultimate consumers of the product are the students of University Corp, this is not considered a digital product provided through an intermediary for application of these rules.” Research Corp would source the receipts based on the primary use location of the digital collection by University Corp—which, based on the contract and Research Corp’s books and records, is New York.
 - As this is the only example in the proposed regulations regarding receipts from digital products wherein it is determined not to involve an intermediary transaction, the rule appears to be that if there is ongoing active involvement/updating, a taxpayer is providing a digital product through an intermediary, and would source receipts from digital products to the ultimate consumer. Conversely, where there is no ongoing active involvement/updating, it appears that a taxpayer is not providing a digital product through an intermediary and would not source receipts from digital products to the ultimate consumer.

Considerations

These regulations were proposed in advance of New York State’s Administrative Procedure Act process to formally propose and adopt regulations. The Department is accepting public comments on these proposed regulations until January 16, 2016. Once adopted, regulations generally are prospective in application.⁸

Taxpayers who may have a view contrary to or not clearly expressed in the proposed regulations may wish to consider contacting the Department by January 16, 2016, either to suggest new wording to a proposed regulation or to request that a more specific example be added. The Department’s proposed regulation rejecting census data in making a reasonable approximation of the location(s) where benefit is received (generally requiring a taxpayer to apply a lower level of the sourcing hierarchy) may be of particular concern to some taxpayers.

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If you have questions regarding these proposed sourcing regulations or other New York tax matters, please contact any of the following Deloitte Tax professionals:

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⁸ New York State Administrative Procedure Act Sec. 203.1.