

Request for Comments on Applying the Characterization Rules in §§1.861-18 and 1.861-19 to All Provisions of the Internal Revenue Code

Notice 2025-6

SECTION 1. PURPOSE

The Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) have published Treasury Decision 10022 containing final regulations (2025 final regulations) that provide rules for characterizing digital content and cloud transactions. [T.D. 10022, xx FR xxxxx (January 14, 2025).] The 2025 final regulations apply solely to certain enumerated international provisions of the Internal Revenue Code (the Code).¹ This notice requests comments on any potential implications if the characterization rules currently contained in §§1.861-18 and 1.861-19, as amended and added, respectively, by the 2025 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. Comments received in response to this notice will help inform the Treasury Department and the IRS's decision regarding whether to apply the characterization rules currently contained in §§1.861-18 and 1.861-19 to all provisions of the Code and what further guidance, if any, should be issued if the regulations were revised in this manner.

¹ Unless otherwise specified, all “section” or “§” references are to sections of the Code or the Income Tax Regulations (26 CFR part 1).

SECTION 2. BACKGROUND

In 1998, in response to rapid technological advances including the growth of transactions in digitized information,² the Treasury Department and the IRS published Treasury Decision 8785, which contains the original final regulations in §1.861-18 (1998 final regulations) that set forth a framework for characterizing transactions involving computer programs. T.D. 8785, 63 FR 52971 (Oct. 2, 1998). This framework is based on copyright law, but takes into account the unique features of digitized information. REG-251520-96, 61 FR 58152, 58153 (Nov. 13, 1996) (“Although the proposed regulations are guided by copyright law principles in determining whether a copyright right or a copyrighted article has been transferred, the regulations depart in some cases from a strict reliance on copyright law in order to take into account the special nature of computer programs and to treat functionally equivalent transactions in the same way.”). The 1998 final regulations broadly group computer program transactions into one of the following categories: transfers of copyright rights, transfers of a copy of the program (a copyrighted article), services for the development or modification of the program, or the provision of know-how relating to computer programming techniques.

The 1998 final regulations focus on the distinction between transfers of the copyright itself and transfers of a copyrighted article with a substance-over-form characterization approach that looks to the underlying rights granted to the transferee. Where a transfer conveys a commercial exploitation right included in the list of enumerated copyright rights (such as the right to make copies of the program for

² See Treasury Department, “Selected Tax Policy Implications of Global Electronic Commerce,” Nov. 1996, at 27-28.

purposes of distribution to the public), the transaction is treated as a transfer of copyright rights. However, if a copy of a program is transferred without one of the enumerated copyright rights (merely granting a right to the transferee to use the copy on its own computer, for example), the transaction is treated as a transfer of a copyrighted article.

The 1998 final regulations further characterize transfers of copyright rights and copyrighted articles as complete or partial transfers. For a transfer of a copyright right, if all substantial rights to the underlying copyright right are transferred, the transfer is classified as a sale or exchange of the copyright right under the principles of §§1222 and 1235. If less than all substantial rights are transferred, the transaction is classified as a license. For a transfer of a copyrighted article, if the benefits and burdens of ownership have been transferred, the transaction is classified as a sale of the copyrighted article. If insufficient benefits and burdens of ownership of the copyrighted article have been transferred, the transaction is classified as a lease. See, e.g., Grodt & McKay Realty, Inc. v. Comm’r, 77 T.C. 1221, 1237–38 (1981); Torres v. Comm’r, 88 T.C. 702, 720–27 (1987); Estate of Thomas v. Comm’r, 84 T.C. 412, 431–40 (1985).

The 1998 final regulations apply solely for purposes of subchapter N of chapter 1 of the Code, §§367, 404A, 482, 551, 679, 1059A, chapter 3, chapter 5, §§842 and 845 (to the extent involving a foreign person), and transfers to foreign trusts not covered by §679. The preamble to the 1998 final regulations states that while such regulations apply only to cross-border transactions involving computer programs, the Treasury Department and the IRS may consider whether to apply the principles of the regulations to all transactions in digitized information as part of a

separate guidance project.

In general, the 2025 final regulations maintain the basic framework from the 1998 final regulations for characterizing transfers of content as primarily copyright rights or copyrighted articles (and subcategorizing as sales or licenses of copyright rights, or sales or leases of copyrighted articles). The 2025 final regulations extend the characterization framework of the 1998 final regulations to transactions involving digital content, which is generally defined as a computer program or any other content protected by copyright law, not just transactions involving computer programs. The 2025 final regulations also include §1.861-19, which provides that cloud transactions (generally defined as transactions through which a person obtains on-demand network access to computer hardware, digital content, or other similar resources) are characterized as the provision of services. Further, the 2025 final regulations implement a predominant character rule for characterizing digital content and cloud transactions.

The 2025 final regulations continue to apply only to certain listed international Code provisions, with updates to eliminate references to repealed §551 and chapter 5, and to add references to §§59A, 245A, 250, and 267A, and chapter 4. The 2025 final regulations retain this limited scope although the Treasury Department and the IRS received several comments recommending that the regulations apply to all provisions of the Code in response to the proposed regulations preceding the 2025 final regulations. As noted in the preamble to the 2025 final regulations, however, the Treasury Department and the IRS continue to study whether the characterization rules currently contained in §§1.861-18 and

1.861-19 should apply to all provisions of the Code. To inform their consideration of and decision on the issue, section 3 of this notice solicits comments.

SECTION 3. REQUEST FOR COMMENTS

The Treasury Department and the IRS request comments regarding any consequences or interactions that would result if the characterization rules currently contained in §§1.861-18 and 1.861-19, as amended and added, respectively, by the 2025 final regulations, were to apply to all provisions of the Code. Comments are requested on any specific areas that would be affected, with examples where appropriate. Comments are also requested on any guidance that would be needed, including what approach such guidance should take. In addition to general comments, the Treasury Department and the IRS request comments, with examples, regarding the desirability and effects, if any, of applying the characterization rules currently contained in §§1.861-18 and 1.861-19 on the rules in the following areas, including whether further guidance in these areas would be necessary and, if so, what the approach of the guidance should be:

- Section 167(f)
- Section 168(g)(1)(B)
- Section 178
- Section 197
- Section 263
- Section 451
- Sections 263A and 471
- Sections 856 through 859

- Sections 1001 and 1011
- Sections 1221 and 1222
- Section 1241

SECTION 4. SUBMISSION OF COMMENTS

.01 Written comments should be submitted by **[INSERT DATE 90 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE INTERNAL REVENUE BULLETIN]**.

Consideration will be given, however, to any written comment submitted after **[INSERT DATE 90 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE INTERNAL REVENUE BULLETIN]**, if such consideration will not delay the issuance of guidance.

The subject line for the comments should include a reference to Notice 2025-6.

Comments may be submitted in one of two ways:

(1) Electronically via the Federal eRulemaking Portal at www.regulations.gov (type IRS-2025-6 in the search field on the regulations.gov homepage to find this notice and submit comments). Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn.

(2) Alternatively, by mail to: Internal Revenue Service, CC:PA:01:PR (Notice 2025-6, Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, D.C., 20044.

.02 All commenters are strongly encouraged to submit comments electronically. The Treasury Department and the IRS will publish for public availability any comment submitted electronically and on paper to its public docket on www.regulations.gov.

SECTION 5. DRAFTING AND CONTACT INFORMATION

The principal author of this notice is Michelle L. Ng of the Office of the Associate Chief Counsel (International). Other personnel from the Treasury Department and the

IRS participated in its development. For further information regarding this notice, call the contact number at (202) 317-6989 (not a toll-free call).