

Rulings of the Tax Commissioner

Document Number: 14-8
Tax Type: Corporation Income Tax
Brief Description: Foreign source income subtraction properly claimed by the Taxpayer
Topics: Records>Returns/Payments; Taxable Income
Date Issued: 01/24/2014

January 24, 2014

Re: § 58.1-1821 Application: Corporate Income Tax

Dear *****:

This will reply to your letter in which you seek correction of the corporate income tax assessments issued to ***** (the "Taxpayer") for the taxable years ended August 31, 2006 through 2008. I apologize for the delay in responding to your letter.

FACTS

The Taxpayer was audited by the Department for the taxable years at issue and numerous adjustments were made. One of the adjustments made by the auditor was to eliminate the foreign source income (FSI) subtraction claimed by the Taxpayer. The auditor determined that the Taxpayer performed services for foreign clients that were not incidental to the rental of real property or the licensing of intangible assets. The Taxpayer appeals the disallowance of the FSI subtractions, contending it primarily licensed intellectual property to its overseas customers and any technical services provided were incidental.

DETERMINATION

Virginia Code § 58.1-302 defines foreign source income, in pertinent part, as:

Rents, royalties, license, and technical fees from property located or services performed without the United States or from any interest in such property, including rents, royalties, or fees for the use of or the privilege of using without the United States any patents, copy rights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other like properties.

Pursuant to the Department's long-standing policy, the words "technical fees from

property located or services performed" cannot be taken out of their context to create a subtraction for income earned from the performance of services outside the United States for any service that can be characterized as of a technical nature. See Public Document (P.D.) 86-209 (11/03/1986). In order to qualify for the Virginia FSI subtraction, "technical fees" must be incidental to a contract relating to the rental of real property or the licensing of a patent or other like property outside the United States. See P.D. 91-57 (3/29/1991).

The Taxpayer states that it is a global provider of management and technology consulting services and solutions. These services include a wide range of solutions to enable a business or government to perform more efficiently. To support its position, the Taxpayer has provided a sample of contracts.

In this case, the Taxpayer has provided copies of contracts pertaining to technology and trademark licenses outside of the United States. These contracts specify that the Taxpayer design, develop and deploy enhancements to existing software. It provides the licensee with various technical information and services that include development, integration, training and testing. All of the contracts are different and provide the licensee with differing levels of technical information and services. Each contract grants a license to the customer for the use of the Taxpayer's proprietary software.

In P.D. 91-57, the Commissioner held that software and operating systems are classified as intangible property for income tax purposes, regardless of whether they are custom or application software and income from the licensing of such software qualifies for the FSI subtraction. The income from the software produced by the Taxpayer and modified to meet the needs of its customers qualifies for the FSI subtraction.

A review of the contract in fact shows the specified services were necessary in order for the technology to be usable and for the foreign licensee to implement the Taxpayer's technology. All the services performed either enabled or assisted the licensee in using the technology to produce and sell tangible personal property. The consideration paid for these services, to the extent those services were performed outside the United States, qualifies as "technical fees" incidental to the licensing of intangible property and is properly included as a Virginia FSI subtraction.

The assessments have been adjusted in accordance with the enclosed schedule and adjusted audit reports. An updated bill, with interest accrued to date, will be sent to the Taxpayer. The outstanding balance should be paid within 30 days of the bill date to avoid additional interest charges. The Taxpayer should remit its payment to: Virginia Department of Taxation, Attention: *****, 600 East Main Street, 23rd Floor, Richmond, Virginia 23219. If you have any questions concerning payment of the assessment, you may contact ***** at *****.

The *Code of Virginia* sections and public documents cited are available on-line at www.tax.virginia.gov in the Laws, Rules & Decisions section of the Department's web site. If you have any questions regarding this determination, you may contact ***** in the Office of Tax Policy, Appeals and Rulings, at *****.

Sincerely,

Craig M. Burns
Tax Commissioner

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