



COLORADO
Department of Revenue

Taxation Division

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PLR-13-008

October 2, 2013

XXXXXXXXXXXXXXXXX
Attn:XXXXXXXXXXXX
XXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXX

Re: Private Letter Ruling

Dear Mr. XXXXXXXXXXX,

You submitted on behalf of XXXXXXXXXXXXXXX ("Company") a request for a private letter ruling to the Colorado Department of Revenue ("Department") pursuant to Regulation 24- 35-103.5. This letter is the Department's private letter ruling.

Issues

1. Is the sale of a digital photograph delivered electronically the sale of tangible personal property for purposes of Colorado income tax apportionment?
2. Other than the certain limited services discussed below (re: OAP maintenance, analytics, etc.), is the sale of digital imagery sold under various methods to various customers described below to be sourced as a sale of tangible personal property for Colorado apportionment purposes?
3. To the extent the products described below are considered tangible personal property, would the sale be sourced to the destination state to which the property is shipped for Colorado apportionment purposes if the Company is taxable in that destination state?
4. If the destination state treats the sale of digital images to the federal government as sourced to the origination state (Colorado), would Colorado source a sale to the federal government to the destination state for apportionment purposes?

Conclusions

1. A static digital image delivered electronically to a purchaser/ consumer is the sale of tangible personal property for purposes of Colorado income tax apportionment.

2. The sale of digital imagery sold under various methods to various customers described below must be sourced as a sale of tangible personal property for Colorado apportionment purposes.
3. The sale is not a Colorado sale if the destination of the product is not in Colorado and Company is taxable in the destination state.
4. Regardless of whether the destination state treats the sale of digital images to the federal government as sourced to the origination state (Colorado), Company must source the sale to the federal government to the destination state for Colorado apportionment purposes.

Background

Company is a global provider of commercial XXXXXXXXXXXX imagery products. A range of products, including XXXXXXXX or XXXXXXXX images, are offered to customers from Company's XXXXXXXXXXXXXXXXXXXX, as well as imagery and other information that is acquired from third party suppliers. Company has two main segments of revenue: XXXXXXXXXXXX and commercial.

Products sold by Company

(REDACTED)

Delivery of Products

Company's XXXXXXXXXXXX and XXXXXXXX imagery sales are subject to an End User License Agreement (EULA) that limits the customer's use of the images to only the uses agreed upon between the customer and Company. The EULA is used to protect Company from unauthorized copying and redistribution of the images. It is used in a manner similar to patent law and copyright law to provide protection against unlawful acts. This type of protection is the norm related to digital media of all sorts.

Most of the images sold are delivered directly to the customer via FTP (electronic delivery) and a few larger orders are delivered on XXXXXXXX drives. This standard EULA provides that the customer makes a one-time payment for a perpetual (subject to the terms of the license), non-exclusive, non-transferable, limited license to (i) access the licensed images, (ii) modify the licensed images subject to limitations in the EULA, and (iii) permit the end users to view the licensed images by downloading, printing, reproducing and transmitting such licensed images for non-commercial purposes (for internal, educational or demonstration purposes only). There is a provision in the EULA that states that Company retains all rights, title and interest, including intellectual property in the licensed imagery, at all time.

Company also has several Re-Sellers ("RS") who purchase and re-sell the imagery. Under this arrangement, the RS purchases imagery from Company based on the RS's customer order. The RS receives the imagery and then sends the imagery to its customer or directs Company to send the imagery directly to the customer. The RS typically does not maintain a database of imagery that it has previously purchased from Company. All customer orders are submitted through Company's system but the images are sent to the RS who then re-distributes that image to its customers, and the

RS has no right to make copies of Company's imagery, not even for re-sale to its customers.

Company ships imagery from two offices in Colorado and another location outside Colorado to customers in the United States and foreign jurisdictions. The imagery is delivered to customer using the distribution method that best suits the customer's needs. Company generally transfers its products using one of two methodologies. The first involves providing the digital data via electronic transmission, and if the customer did not receive the imagery, then Company would retransmit the imagery as many times as necessary until the end user received the imagery at no additional cost to the customer. The second method involves Company putting the digital data on a tangible medium (disk, XXXXXXXX drives, etc.) and sending the product to the customer. In practice, if the digital imagery was shipped via tangible medium and the customer did not receive it, Company would replace it at no additional cost to the customer. Based on these facts, Company believes that "risk or loss" passes to the customer only when the customer satisfactorily receives the imagery because Company bears the burden of shipping or transmitting that imagery until it is received by the customer. Company believes the subsequent "beneficial ownership" passes to the customer once the data is successfully received by them at their location.

Discussion

Corporations that derive income from sources both inside and outside this state must apportion their income between and among the states using single-factor apportionment.¹ Revenue from the sale of tangible personal property is apportioned to the state in which the property is delivered to the purchaser or recipient.²

Company sells digital images to customers pursuant to an EULA, which is primarily intended to prohibit customers from copying and reselling the images. This license is non-exclusive, which allows Company to sell the image to multiple customers, much like license agreements that allow iTunes, Netflix, and Amazon to resell digital music, movies, and books. The Department has previously issued advice that the sale of digital goods, such as digital music, books, movies, magazines, and photographs delivered electronically are tangible personal property.³ We perceive no substantial difference between Company's XXXXXXXX imagery and other digital photographs.⁴

¹ Department Regulation 39-22-303.5.3(1), effective for tax years beginning on or after January 1, 2009.

² §39-22-303.5(4)(b), C.R.S. and Department Regulation 39-22-303.5(4)(8).

³ General Information Letter GIL-11-014. Moreover, Company's customers, who are granted a license to use and, in some cases, transfer the digital photographs, have more than a mere intangible intellectual property right. See, e.g., *American Multi-Cinema, Inc. v. City of Westminster*, 910 P2d 64, 07/13/1995 and reaffirmed in *Cinemark v. City of Fort Collins*, 190 P3d 793 (Colo. 2008) (rejecting taxpayer's contention that its contractual right to display movies was merely an intangible intellectual property right).

⁴ Company represents that its sales agreements with the XXXXXXXXXXXX give the XXXXXXXXXXXX first priority in the use of Company's XXXXXXXXXXXX. Company further represents that the XXXXXXXXXXXX does not control the XXXXXXXXXXXX other than to designate the images to be taken. This first priority may suggest to some that the XXXXXXXXXXXX is purchasing a service, not tangible personal property. We believe such a characterization is incorrect. The true object of the transaction is the purchase of photographs and the XXXXXXXXXXXX simply pays a premium for the right to purchase those photographs on demand.

Therefore, we rule that income derived from the sale of such digital imagery is from the sale of tangible personal property for purposes of apportioning Colorado income tax.⁵ More specifically, the income derived from such sales is apportioned inside and outside Colorado based on the place of delivery to the purchaser or recipient if the Company is taxable in the state in which the digital photographs are delivered.⁶

Company often sells digital photographs to the XXXXXXXXXXXXXXXXXXXX. Purchases are typically made by one XXXXXXXXXXXXXXX, which purchases the photographs on behalf XXXXXXXXXXXXXXXXXXXX, which may be located in states other than the state in which the purchasing agency is located. Department Regulation 39-22-303.5.4(8) provides that a sale is sourced to Colorado if the tangible personal property is delivered into Colorado when the purchaser is located in Colorado or if the property is ultimately delivered into Colorado to a recipient in Colorado. Thus, Company's sales of digital photographs are sourced to Colorado if the photographs are delivered into Colorado.⁷

Some states source sales XXXXXXXXXXXXXXXXXXXX to the state from which the sale originates. Company asks whether sales XXXXXXXXXXXXXXX, which are not sourced to Colorado under Colorado's sourcing rules, remain sourced to those other states for Colorado income tax purposes when the other state(s) source the income from such sales to Colorado.⁸ Colorado sources sales of tangible personal property in accordance with the aforementioned Department regulations and the result is not altered if the other state(s) has different apportionment rules. Therefore, we rule that Company sources income to the destination state in accordance with Colorado apportionment regulations regardless of whether the destination state sources such sales to Colorado.

Miscellaneous

This ruling is premised on the assumption that Company has completely and accurately disclosed all material facts. The Department reserves the right, among others, to independently evaluate Company's representations. This ruling is null and void if any such representation is incorrect and has a material bearing on the conclusions reached in this ruling. This ruling is subject to modification or revocation in accordance to Department Regulation 24-35-103.5.

Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling will be made public within 60 days of the date of this

⁵ Company provides certain services related to the sale of the digital photographs (maintenance and analytics), which are apportioned as services.

⁶ Company's income is taxable in another state if it meets either one of two tests: (1) if by reason of business activity in another state, the taxpayer is subject to one of the types of taxes specified in 39-22-303.5(3)(c)(1) (i.e., net income tax, a franchise tax measureD by net income, a franchise tax for the privilege of doing business, a corporate stock tax, or other similar tax; or (2) if by reason of such business activity, another state has jurisdiction to subject the taxpayer to a net income tax, regardless of whether or not the state imposes such a tax on the taxpayer.

⁷ The Colorado legislature declined to adopt a separate XXXXXXXXXXX sales rule when it adopted the single sales factor apportionment.

⁸ The net result in such cases being that this sale is not included in the numerator of any state apportionment formula.

letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted version of the ruling.

Sincerely,

Neil L. Tillquist
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This ruling cannot be relied upon by any other taxpayer other than the taxpayer to whom the ruling is made.