



This Week in State Tax (TWIST)

October 31, 2022



PENNSYLVANIA



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Pennsylvania: Digital Goods Sourced for Corporate Net Income Tax Purposes Using Rules for TPP

The Pennsylvania Board of Finance and Revenue recently denied a petition protesting the Department's application of the sourcing rules for tangible personal property to the taxpayer's sales of digital content. The taxpayer at issue entered into licensing agreements with content rights holders to license and distribute spoken audio content in exchange for royalty payments. The copyrighted content was sublicensed to the taxpayer's customers, who were granted a limited license to download and use the digital content. On its original corporate net income tax returns, the taxpayer applied the costs of performance method to source its receipts. On audit, it was uncovered that a past decision of the Board of Finance and Revenue had classified the taxpayer's sales as sales of tangible personal property, and the auditor adjusted the sales factor for the current period accordingly. After the Board of Appeals denied relief, the taxpayer appealed. In the taxpayer's view, its receipts should be classified as sales of intangible personal property sourced using the costs of performance method. The taxpayer contended the majority of its labor costs to maintain its digital content and execute licensing agreements (among other activities) occurred in New Jersey at its headquarters, meaning its receipts should be sourced to New Jersey.

The Board denied the appeal on the basis that the taxpayer had not established that it was selling intangibles. In the Board's view, the taxpayer was in fact selling tangible personal property that should be sourced based on delivery location. The Board found that the digital audio books sold by the taxpayer were akin to tangible personal property under the "essence of the transaction" test that is typically applied in the sales tax context to determine the nature of a sale. The Board noted that the books were mass produced and not customized for each customer, contained knowledge recorded in a physical form which had physical existence, and took up space on a tangible medium (e.g., disc or hard drive). In the Board's view, the digital audio file, when downloaded by the customer, was ultimately a book recorded and stored in physical form upon a physical object. The Board also denied the taxpayer's request for a special apportionment method. Please contact [Mark Achord](#) with questions on BF&R Docket No. 2122314.



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