

11B.04[5] Title Passage in Electronic Delivery of Software

This section addresses the special considerations for sourcing a sale of downloaded software that is classified as a sale of a copyrighted article. As discussed at ¶ 11B.04[6][a], such a sale is classified in a manner similar to a sale of inventory property. Inventory is sourced, in whole or in part, to the place where title to the property passes.⁷⁸ There are no specific rules for determining where title passes when software is downloaded from a Web site.^{78.1} To identify the place where title passes, we use the general rules, plus what little guidance there is in the software regulations.

Example 11B-5.1

ForeignWebCo, a Country X corporation, sells software that is downloaded from its Web site. If the software is downloaded from a server in Country X, it is conceivable that the title will be deemed to have passed there, because, in the case of an off-the-shelf sale of software (on CD), title could have passed in Country X. On the other hand, if the buyer receives the software on a computer in the United States, it could be argued that title passes in the United States. As discussed in the remainder of this section, there is no certainty where passage of title takes place, especially if there is no explicit indication in the software license of the location at which title passes. As we will see, the seller's best option is to use the license to designate title.

¶ 11B.04[5][a] General Rule for Passage of Title

Under the general rules, the passage of title occurs in the country where the rights, title, and interest of the seller in the property are transferred to the buyer. Where bare legal title is retained by the seller, the sale is deemed to have occurred at the time and place of passage to the buyer of beneficial ownership and the risk of loss.^{78.2} Where goods are delivered physically, passage of title is often controlled by the contract. For instance, title will pass at the buyer's location if the goods are free-on-board (FOB) destination. If the contract does not control the passage of title, then title ordinarily passes where the buyer acquires the burdens and benefits of ownership.

With regard to most software sold online, title to the software does not pass in the literal sense. Instead, customers acquire licenses to use the software. In addition, risk of loss rules are hard to apply because it is difficult to suffer a loss in the electronic transfer of software—that is, if a software download fails, the software can simply be retransmitted. Even so, as discussed at ¶ 11B.04[5][b], the preamble to the software regulations states that the passage of title rules will be applied to software in the same manner as they are applied to transfers of other kinds of goods. ^{78.3}

¶ 11B.04[5][b] Passage of Title Under Software Regulations

In determining the location of the passage of title of downloaded software, we can first look to the software regulations. The preamble to the [Section 861](#) regulations provides some authority for a seller to use the license (or contract) that accompanies the sale to designate the location of the sale. The preamble to the regulations says, an “electronic transfer is generally not accompanied by the usual indicia of the transfer of title.” Moreover, the preamble states that

As to the issue of determining the place of sale under the title passage rule of [§ 1.861-7\(c\)](#), the parties in many cases can agree on where title passes for sales of inventory property generally. Consistent with the overall policy of the regulations, income from electronic transfers of computer programs that constitute inventory property, classified as sales of copyrighted articles, will be sourced under similar principles. ^{78.4}

This seems to indicate that a seller can choose the location of a sale, and thereby determine the source of a transaction involving electronically delivered software. With regard to transactions involving digital products, this gives the parties considerable flexibility to determine where a sale takes place.

¶ 11B.04[5][c] Using Contract or License to Control Passage of Title

As discussed at ¶ 11B.04[5][b] above, it may be possible to control the passage of title of downloaded software using the software license or contract. Such designation can be done in a “click wrap” license that is digitally signed by the buyer, which specifically identifies the place of sale and the country with jurisdiction over the sale. Where there is such a designation, there should be some degree of substance to the location of title passage indicated in the license. That is, if possible the parties' designation of the place where title passes should not be different from the place where the benefits and burdens of ownership actually pass. For instance, if the liability to pay for a digital product does not arise until the customer has successfully downloaded the product, then the benefits and burdens of ownership do not seem to pass until the product is successfully downloaded. If this is the case, the transfer cannot occur before the product is recorded on a customer's computer; in which case, the transfer seems to take place at the location of that computer.

A good reason for controlling the passage of title using the license is the buyer's location may not be known. As discussed at ¶ 11B.03[8], the seller often does not need to know the buyer's location in order to complete most digital transactions, and it may be impossible to know the location of the computer to which the software is downloaded. In such a case, the license may be the only indication of the source of the sale.

¶ 11B.04[5][d] Using Place of Receipt to Determine Passage of Title

Absent a specific designation in a contract or license as to where title passes, the regulations state that title passes at the location where the benefits and burdens of ownership change hands.^{78.5} This location is generally where the buyer has beneficial ownership and a risk of loss. A buyer of downloaded software may have beneficial ownership of software when the software has been received, and the buyer owns the software. When software is downloaded from a Web site, the software goes to the computer of the person initiating the transfer, and is recorded on that computer's hard disk. When this occurs the buyer has receipt of the software, and we can argue that the place of receipt is the location of the passage of title.

The verity of a rule that says title to downloaded software passes when software is received on a buyer's computer is illustrated by the situation where software is transferred from the seller's computer (i.e., the Web server) but is never received by the buyer's computer. This can, and does, happen where there is some telecommunications failure. Is the buyer still obligated to pay for the program when such a failure takes place? One would hope not. The seller has not really lost anything, and it does not seem likely the seller would enforce payment from a buyer who did not receive anything. The assumption that a buyer is not obligated to pay for a program that is sent but not received supports the idea that the buyer's computer can be the place where title passes.

However, where a digital product is purchased for download, the customer is often given access to an online download area from which the product can be downloaded. If a certain download is unsuccessful, the purchaser can access the download area to try again. This seems to indicate that a copy of the program is set aside for the customer at the location of the seller's computer. If, in such a case, the location of the sale is designated as the seller's computer (which may be desirable for non-tax reasons), this designation is not out of line with the substance of the transaction, and may be the place where the benefits and burdens of ownership appear to shift to the buyer.

¶ 11B.04[5][e] Purchased Software Stored on Seller's Computer

Sometimes a buyer does not take immediate receipt of the software on his or her computer, but remains liable for immediate payment for the software. This calls into question the determination of passage of title based on the location of the computer to which the downloaded software is sent. For example, a company may purchase a license for 100 copies of a particular software program; and once purchased the company is given requisite codes to download 100 copies of the software from the vendor's Web server. The company may provide employees in various countries with the codes to download individual copies of the program. Under these circumstances, downloads may be deferred for months, as various employees are given download codes. During this period, the buyer clearly enjoys the benefits of owning the software, even if all copies are not currently being used. The fact that the buyer enjoys the benefits of

owning the software that still resides on the seller's Web server could argue for treatment of the server location as the place where title passes.