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U.S. Tax Court: Fees for use of securities exchanges not deductible under section 199

The U.S. Tax Court today issued an opinion concluding that the taxpayer was not entitled to treat fees received from customers in connection with their participation in national securities exchanges as domestic production gross receipts (DPGR) for purposes of section 199 (as then in effect for the years at issue) because the fees were not derived from providing customers access to computer software for their direct use.

The case is: *Bats Global Market Holdings, Inc. v. Commissioner*, 158 T.C. No. 5 (March 31, 2022). Read the Tax Court's [opinion](#) [PDF 278 KB] (35 pages)

Summary

The taxpayer operated national securities exchanges and developed computer software that it used to operate the exchanges.

The taxpayer charged its customers certain fees in connection with their participation on the exchanges (transaction fees, routing fees, and logical port fees). The taxpayer treated the gross receipts from these fees as DPGR for the purpose of calculating deductions pursuant to section 199, which it claimed with respect to years 2011-2013.

Section 199 provides a tax deduction for certain domestic production activities. Specifically, section 199(a) allows a deduction equal to 9% of the lesser of: (1) the qualified production activities income of the taxpayer for the tax year; or (2) taxable income (determined without regard to section 199) for the tax year. Qualified production activities income for any tax year is an amount equal to the excess, if any, of (A) the taxpayer's DPGR for such tax year, over (B) the sum of (i) the cost of goods sold allocable to such receipts and (ii) other expenses, losses, or deductions (other than the deduction under section 199) that are properly allocable to such receipts.

The IRS determined that none of the gross receipts from the fees was DPGR because under the applicable regulations, a taxpayer can treat as DPGR those gross receipts derived from providing customers access to computer software for the customers' direct use. Further, a third party must

derive gross receipts from the disposition in a tangible medium or by download of substantially identical software (as compared to the taxpayer's software) to its customers.

The Tax Court agreed with the IRS and held that the taxpayer was not entitled to treat the gross receipts from the fees as DPGR because the fees were not derived from providing customers access to computer software for their direct use.

The Tax Court held in the alternative that the taxpayer was not entitled to treat the gross receipts from the fees as DPGR because the third-party software proposed as comparable by the taxpayer was not substantially identical software as compared to the taxpayer's software.

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