

IRAS CIRCULAR

EXEMPTION OF SOFTWARE PAYMENTS FROM TAX (Revised Edition)



INLAND REVENUE
AUTHORITY
OF SINGAPORE

Published by
Inland Revenue Authority of Singapore

Published on 29 Dec 2000
First revision on 23 Feb 2001
Second revision on 1 Mar 2005
(Editorial revisions have been made to paragraphs
1.2, 1.3, 2.1.3, 3.2, 5.2.1, 5.3.1, 5.5.1 & 6.
Paragraphs 3.3 & 5.5.3 were added to the tax guide).

© Inland Revenue Authority of Singapore

All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, including photocopying and recording without the written permission of the copyright holder, application for which should be addressed to the publisher. Such written permission must also be obtained before any part of this publication is stored in a retrieval system of any nature.

IRAS CIRCULAR

EXEMPTION OF SOFTWARE PAYMENT FROM TAX

1 INTRODUCTION

- 1.1 Software payments are classified as royalty payments for tax purposes. Royalty payments made to non-resident persons by Singapore-resident persons or permanent establishments are deemed to be sourced in Singapore under section 12(7) of the Income Tax Act. Accordingly, the payer has to withhold tax on the payments at 15%¹, or such reduced rate as provided under a tax treaty.
- 1.2 On 11 November 2000, the government announced that royalty payments made to non-residents for shrink-wrap software will be exempt from tax. This applies to royalty income accruing on or after 1 January 2001. As a result, end-consumers (both individuals and businesses) and resellers of shrink-wrap software are no longer required to withhold tax on such payments.
- 1.3 On 23 February 2001, the Minister for Finance further announced in his Budget Statement that royalty payments made to non-resident persons for the following categories of software payments *accruing on or after* 23 February 2001 will also be exempt from tax:
- (i) Downloadable Software for End-User
 - (ii) Site Licence
 - (iii) Software bundled with computer hardware

2 DEFINITIONS

2.1 Shrink-wrap Software

- 2.1.1 Shrink-wrap software is software distributed in wrapped boxes (usually in the form of compact discs or diskettes) accompanied by what is generally referred to as a shrink-wrap licence. The buyer receives the right to use the program on his computer but is not permitted to modify it in any way.
- 2.1.2 Under the licence, no reverse engineering, decompilation, or disassembly of the computer program is permitted.
- 2.1.3 The buyer generally receives the right to use the program on a single computer, or a specified number of computers at any one time.

¹ For royalty payments accruing on or after 1 January 2005, the rate of tax is reduced to 10%.

- 2.1.4 The buyer is permitted by the shrink-wrap licence to resell the copy so long as he destroys any other copies he has made and imposes the same terms and conditions of the licence on the next buyer.
- 2.1.5 Typically, shrink-wrap software are standard software such as computer games, operating system software and office application software that are available for sale off-the-shelf.

2.2 Downloadable Software for End-User

- 2.2.1 Downloadable Software for End-User is software downloaded by an end-user from the Internet or a network for a fee. It is the equivalent of shrink-wrap software except that instead of being stored on CDs or diskettes, it is distributed over the Internet or a network. It is sometimes referred to as “Webwrap” or “Clickwrap” software.
- 2.2.2 An “End-User” is a software user who acquires the right to run the software on a single computer or a computer network but not the right to exploit the copyright to the program.

2.3 Site Licence

- 2.3.1 A Site Licence refers to a software licence that allows the licensee to install the software on multiple computers or servers for operation within its own business, location or facility.
- 2.3.2 The licence generally grants the rights to operate the program but prohibits the selling-on of the software and the reverse engineering of the program.

2.4 Software Bundled With Computer Hardware

- 2.4.1 Software bundled with computer hardware is computer software that has been pre-installed in the computer hardware, and the software and computer hardware are sold together as a single product, without the software and computer hardware being priced separately. The buyer receives the right to use the program on the computer hardware but not to modify or resell the software on its own.

3 HOW WILL THE EXEMPTION BE APPLIED

- 3.1 The tax exemption is effected under section 13(4) of the Income Tax Act on royalty income accruing on or after:
 - (i) 1 January 2001 for shrink-wrap software;

- (ii) 23 February 2001 for
 - downloadable software for end user;
 - site licence; and
 - software bundled with computer hardware.

3.2 The exemption applies on payments made to a non-resident person except where the payments constitute income derived from a trade, business, profession or vocation carried on or exercised by that person in Singapore, or which is effectively connected with any permanent establishment of that person in Singapore. Accordingly, the payer need not withhold tax on such software payments made to a non-resident person.

3.3 Generally, to qualify for the exemption on the above 4 categories of software payments, the buyer must not:

- a) obtain any right to exploit the copyright of the software;
- b) receive any right to duplicate copies of the software;
- c) have any right to modify, reverse engineer or decompile the software;

under any of the agreement or arrangement with the seller.

3.4 In the case of payment for site licence, if the payment includes an amount for maintenance and rendering of assistance in connection with the use of that software, then the whole amount will be exempted.

4 ADMINISTRATIVE CONCESSION

4.1 As the tax exemption does not apply on software payments made to a non-resident person where the payments are income derived from a trade, business, profession or vocation carried on or exercised by that person in Singapore, or which is effectively connected to any permanent establishment of that person in Singapore, withholding of tax is required for such payments under the Act.

4.2 However, as an administrative concession, the Comptroller of Income Tax has decided to waive the requirement on the payer to withhold the tax on payments pertaining to the 4 categories of software mentioned above if the non-resident person carrying on or exercising a trade, business, profession or vocation in Singapore, who receives such payments, declares or continues to declare such payments as income in his annual tax return.

5 QUESTIONS & ANSWERS

5.1 **The questions and answers relate to the exemption set out in the above paragraphs. All the conditions of the exemption spelt out above will apply to the scenarios given below.**

5.2 General Questions

5.2.1 *Who benefits from the tax exemption of such software payments?*

Technically, the non-resident person is liable for the tax, and the local purchaser of such software is to withhold the tax from the payments being made to the non-resident. However, we understand that in practice, it depends on the bargaining powers between the local purchaser and the non-resident. Our local purchasers would effectively end up bearing the tax if they do not have the bargaining powers in the transaction. The exemption of such software payments from tax would therefore benefit anyone who bears the tax presently.

5.2.2 *What is the rationale behind these exemptions?*

The rationale behind these exemptions is to encourage the development of the IT industry in the light of Singapore's move to develop a knowledge-based economy and the changing business environment. We have had feedback from IT-related MNCs and SMEs that removing the need to withhold tax for these software transactions would contribute to the development of IT and knowledge-based industries. This would also promote the use of software by individuals and businesses in Singapore.

5.3 Shrink-wrap Software

5.3.1 *Does the exemption apply on payments made by a person who acquires the shrink-wrap software for resale purposes, e.g. a Singapore distributor of a shrink-wrap software who acquires software from a non-resident vendor?*

Yes, it makes no difference if the buyer of the boxes of shrink-wrap software can subsequently resell these boxes of shrink-wrap software to the next purchaser. However, this exemption does not apply to payments made by buyers who acquire the rights to manufacture the shrink-wrap software in Singapore.

5.3.2 *If the non-resident delivers the shrink-wrap software to a Singapore distributor but the shrink-wrapping of the box is done locally by the Singapore distributor, is the Singapore distributor still required to withhold tax on his payments to the non-resident?*

If the payment is for the shrink-wrap software and the nature of the transaction is still the import of the shrink-wrap software, even though the shrink-wrapping is done in Singapore, the Singapore distributor is **not** required to withhold tax on his payments for such software.

5.3.3 *If the non-resident delivers a master copy of the shrink-wrap software and the compact discs are pressed, packed and shrink-wrapped by the Singapore distributor, is the distributor still required to withhold tax on his payments to the non-resident?*

In this case, the distributor has actually acquired the right to reproduce the software. This is beyond the scope of a shrink-wrap licence. Hence, the exemption does not apply and the distributor has to withhold tax on the payments being made to the non-resident.

5.4 Downloadable Software for End-User

5.4.1 *Would the tax exemption apply on payments made to non-residents for software downloaded and used as a master copy to manufacture compact discs or diskettes for resale purposes?*

No, the tax exemption only applies on payments for software downloaded for end-consumption.

5.5 Site Licence

5.5.1 *Would the tax exemption apply on payments made to non-residents for services provided to customize software?*

The exemption applies only to payments for software. However, if payment for the software includes payment for maintenance and support services incidental to the purchase of the software, then the full amount including that amount for the maintenance and support will be exempt.

However, if in addition to the payment for site licence, payments are made for additional services such as training for users, customization of the software and/ or development of add-on applications by building onto the existing basic software, such payments for services are not within the scope of this exemption. The payments for these services are taxable under section 12(7) of the Income Tax Act and the payer is required to withhold tax on the gross amount paid².

5.5.2 *Are subsequent payments for software maintenance and support services exempted from tax?*

No, payments for subsequent software maintenance contracts are considered technical services taxable under section 12(7) of the Income Tax Act except for services that are rendered outside Singapore.

5.5.3 *Would the exemption apply to payments made by a distributor of downloadable software or site licences to the original non-resident software vendor?*

If the distributor receives any right to on-sell additional copies or licences of the software under any kind of arrangement with the

² The tax on payments for such services is however exempted under the 1977 administrative concession if the services are rendered outside Singapore.

software vendor, the payment cannot qualify for the tax exemption. For example, where the distributor pays for the placement of software on his own website which allows subsequent users to purchase copies of the same software from the website, the payment for the purchase of the software by the distributor is not exempted from tax.

However, if the distributor is merely acting as a collecting and marketing agent such that payments for each download or purchase of a site licence by end-users are collected by the distributor on behalf of the original software vendor, payments by the distributor to the original software vendor constituting such collections will be exempted from tax.

5.6 Software Bundled With Computer Hardware

5.6.1 *Does the exemption apply where the local manufacturer pays a licence fee to a non-resident for the right to manufacture the bundled computer product in Singapore?*

No, the exemption does not apply on such licence fees. It only applies strictly to payments made to the non-resident for purchase of the entire bundled product.

5.6.2 *Does the exemption apply on payments made to a non-resident by a local distributor who acquires the bundled computer product purely for resale purposes?*

Yes, the exemption applies if the bundled computer product is purchased for resale purposes.

6 ENQUIRIES

6.1 For any enquiries or clarification on this guide, please call 1800-356 8300 (Individual) or 1800-356 8622 (Corporate).