

IRAS e-Tax Guide

**Rights-Based Approach for
Characterising Software Payments and
Payments for the Use of or the Right to Use
Information and Digitised Goods**



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Table of Contents

	Page
1 Aim.....	1
2 At a glance.....	1
3 Glossary	2
4 Background.....	4
5 Current tax treatment	4
6 Rights-based approach for characterising specified payments.....	5
7 Examples of payments for copyright rights & copyrighted articles ..	7
8 Administrative procedure	9
9 Contact information.....	9
Annex – Comparison of withholding tax implications.....	10

Rights-Based Approach for Characterising Software Payments and Payments for the Use of or the Right to Use Information and Digitised Goods

1 Aim

- 1.1 This e-Tax Guide explains the rights-based approach for characterising payments for software and payments for the use of or the right to use information and digitised goods (herein referred to as “specified payments”).

2 At a glance

- 2.1 Payments that do not involve the transfer of the “copyright rights” embedded in the goods will be considered as payments for “copyrighted articles” instead of “copyrights”. Payments for copyrighted articles are characterised as business income and not royalties. Such payments to non-resident persons will not fall within the ambit of section 12(7) of the Income Tax Act (“ITA”).
- 2.2 The rights-based approach will be adopted with effect from 28 Feb 2013. With the rights-based approach, the withholding tax exemptions granted for software payments¹ and payments for the use of or the right to use information and digitised goods², will no longer be necessary.

¹ Withholding tax exemption for software payments was granted under section 13(4) of the Income Tax Act (“ITA”). Details were provided in IRAS e-Tax Guide entitled “Exemption of Software Payments from Tax” (published on 29 Dec 2000 and revised on 23 Feb 2001 and 1 Mar 2005).

² Withholding tax exemption for the use or the right to use information and digitised goods was granted under section 13(4) of the ITA. Details were provided in IRAS e-Tax Guide entitled “Exemption of Payments for the Use of or the Right to Use Information and Digitised Goods by End-Users from Withholding Tax” (published on 28 Feb 2003).

3 Glossary

3.1 Complete alienation

A sale where consideration is paid for the perpetual transfer of:

- the full legal and economic ownership; or
- the full economic ownership in respect of a specific geographical location,

of the exclusive rights in the copyright that constitutes a distinct and specific property.

3.2 Digitised goods

Text, images or sounds that are transferred through any telephone network, cable network, satellite, the internet, or other similar forms of electronic transmission. Examples of digitised goods include online or downloadable songs, music videos, films, books, games, ring tones, logos, and other similar goods.

3.3 Information

- Proprietary data or text or other content comprised in any newspaper or magazine article or report, including financial and business data (such as foreign exchange, stock and property data)
- Other proprietary data and information obtained solely for research purposes

Payments for information include subscriptions to Bloomberg, Reuters, Lexis-Nexis and other similar subscriptions. For purpose of applying the rights-based approach, payments for information exclude payments for the use of or the right to use patents, trademarks, registered design, geographical indications, layout design of integrated circuit, plant variety and trade secret.

3.4 Software

A programme, or series of programmes, containing statements or instructions to be used directly or indirectly in a computer in order to accomplish a certain desired result. A software may comprise any media, user manuals, documentation, database or similar item if these are incidental to the operation of the software. Payments for software include payments for downloadable software, software bundled with hardware, software licence (site, enterprise or network), limited duration licensed software and software product with online elements.

3.5 Specified payments

Payments for software and payments for the use of or the right to use information and digitised goods.

4 Background

- 4.1 The delivery models and licensing arrangements for software, information and digitised goods such as music and movies have evolved and grown over time. There is increased recognition that the payments by end-users of software and digitised goods do not involve the transfer of rights to exploit the copyrights embedded in the software or goods. Such payments are for the copyrighted articles rather than the embedded copyrights.
- 4.2 In line with international practices, the adoption of the rights-based approach in characterising specified payments will provide more certainty for payers.

5 Current tax treatment

5.1 Software payments

- 5.1.1 Currently, all payments for the use of software are classified as royalty payments for tax purposes. Royalty payments made to non-resident persons are deemed to be sourced in Singapore under section 12(7)(a) of the ITA. Accordingly, a payer has to withhold tax on such payments made to a non-resident person at the rate of 10%³, or such reduced rate as provided under a tax treaty.
- 5.1.2 Withholding tax exemption is granted for 4 categories of software payments, covering the following transactions for end-users of:
- a. Shrink-wrap software;
 - b. Site-license;
 - c. Downloadable software; and
 - d. Software bundled with computer hardware.
- 5.1.3 To qualify for the exemption, the payer must not have obtained any right to exploit the copyright of the software, including any right to duplicate, modify, reverse engineer or decompile the software.

5.2 Payments for the use of or the right to use information and digitised goods

- 5.2.1 Payments for information are treated as payments for the use or right to use “scientific, technical, industrial or commercial knowledge”. Under section 12(7)(b) of the ITA, such payments to a non-resident person are deemed to be sourced in Singapore and subject to withholding tax under section 45A of the ITA.

³ Section 43(3A) of the ITA.

5.2.2 Payments for the use or right to use digitised goods like downloadable music, movies and books may also be treated as royalty payments under section 12(7)(a) or payments for information under section 12(7)(b) of the ITA, depending on the specific nature of the digitised goods.

5.2.3 Withholding tax exemption is granted for payments to non-resident persons by end-users for information and digitised goods⁴. An end-user must not have acquired the right to exploit the copyright of the information or digitised goods. Instead, the end-user is only given the right to use the information or digitised goods for personal consumption or for use within his business operations.

6 Rights-based approach for characterising specified payments

6.1 Scope

6.1.1 The rights-based approach sets out the framework for characterising specified payments.

6.2 Principles of the rights-based approach

6.2.1 The rights-based approach characterises a payment based on the nature of the rights transferred in consideration for the payment. It draws a distinction between the transfer of a “copyright right” and the transfer of a “copyrighted article” from the owner to the payer.

Copyright right

6.2.2 A transaction involves a copyright right if the payer is allowed to commercially exploit the copyright. The term “commercially exploit” means to be able to:

- a. reproduce, modify or adapt and distribute the software, information or digitised goods; or
- b. prepare derivative works based on the copyrighted software program, information or digitised goods for distribution.

6.2.3 Generally, the payer is granted the use of the software, information or digitised good in a manner (i.e. to exploit the rights that would otherwise be the sole privilege of the copyright holder) that will, without such granting of use, constitute an infringement of the copyright.

Copyrighted article

6.2.4 A copyrighted article is transferred if the rights are limited to those necessary to enable the payer to operate the software or to use the

⁴ The withholding tax exemption expires on 28 Feb 2013.

information or digitised goods, for personal consumption or for use within his business operations. In many instances, the user is provided with a copy of the product which is downloaded to a device for use. Any right obtained to enable the end-user to copy the digital signal onto a media is incidental to the process in which the content is captured and stored and does not constitute a transfer of the copyright right.

6.2.5 In some cases, a payer may obtain multiple rights in one payment. In determining whether a payment is for the right to use a copyrighted article or a copyright right, the primary purpose of the payment will be examined. For example, where a customer downloads a book for personal enjoyment, the payment is primarily for the acquisition of a copyrighted article (i.e. a copy of a book). To the extent the act of copying the digital signal onto the customer's device involves a right to copy the content, such a right is ancillary and incidental. It corresponds to what the payment is essentially in consideration for (i.e. payment for a copyrighted article).

6.3 Tax treatment of copyright right versus tax treatment of copyrighted article

Copyright right

6.3.1 Where a payment is made to a copyright owner for the transfer of partial rights in the copyright as in the case of licensing of the copyright to be exploited by the payer, the payment is a royalty. When such a payment is made to a non-resident person, it is subject to withholding tax.

6.3.2 Adopting the rights-based approach to characterise specified payments will not result in any change in the existing tax treatment. Royalty payments arising from a partial transfer of the copyright right will continue to be treated as royalties or payments for the use of or right to use movable properties or information under section 12(7) of the ITA. Withholding tax under section 45A remains applicable if the payments are made to a non-resident person.

6.3.3 As for payments made to the copyright owner for a complete alienation of his copyright in the software, information or digitised goods, the transaction is a sale of the copyright. In the hands of the copyright owner, any gains derived by him from such a transaction constitutes either his business income (if the copyright right constitutes his stock in trade) or capital gains. When the sale consideration is paid to a non-resident person, the payment is not subject to withholding tax. This treatment remains under the rights-based approach.

Copyrighted article

6.3.4 As explained in paragraph 6.2.4, a payment for a copyrighted article is not royalty payment. Such payments made to a non-resident person will thus not fall within the ambit of section 12(7) of the ITA. The non-

resident person will not be taxable on such payments unless the payments constitute income derived from a trade or business carried on by him in Singapore or income effectively connected with any permanent establishment of that person in Singapore. Accordingly, the payer will no longer be required to withhold tax under section 45A when he makes such payments to the non-resident person⁵.

6.3.5 Please refer to the Annex for a comparison of the withholding tax implications for payments made to a non-resident owner under the current treatment and the rights-based approach.

7 Examples of payments for copyright rights & copyrighted articles

7.1 Payments for software

By a distributor (without the right to reproduce copies of software)

7.1.1 The distributor is granted the right to distribute software by the software or copyright owner but does not have the right to reproduce copies of the software. Typically, the software is maintained in a server that is operated by the software or copyright owner. When the distributor makes a sale, he provides the customer with a 'key' for the customer to access and download the software directly from the software owner's server. The distributor is not considered to be commercially exploiting the copyright rights in the software. Accordingly, payments made by the distributor to the software or copyright owner are treated as business income in the latter's hands.

By a distributor (with the right to reproduce copies of software)

7.1.2 The software or copyright owner may arrange for the master files of the software to be hosted on the distributor's server. Upon making a purchase, the customer downloads a copy of the software from the distributor's server. In this case, the distributor is arguably given the right to make copies of the software for distribution. The payments or part of the payments made by the distributor to the software or copyright owner may constitute royalties. Nonetheless, IRAS recognises that the specific arrangements and rights conferred in each case vary and the fact that customers may download the software directly from the distributor's server is not conclusive that the payments are for copyrights. IRAS is therefore prepared to examine the facts of such a case in determining the character of payments made to the software or copyright owner.

⁵ However, where the payments constitute income derived from a trade, business, profession or vocation carried on or exercised by the non-resident in Singapore, or which is effectively connected with any permanent establishment of that person in Singapore, the non-resident person is required to file an income tax return to declare the income which is subject to tax in Singapore.

By an end-user

7.1.3 The end user purchases a software. The payment for which includes an amount for maintenance and support services incidental to the purchase of the software. The full amount, including that amount for maintenance and support, is characterised as payments for a copyrighted article.

7.1.4 The end user may make payments for additional services such as subsequent software maintenance and support services, user training, customisation and development of add-on applications by building onto the existing basic software. These are not within the scope of application of the rights-based approach. Such payments for services may fall within the scope of section 12(7)(b) of the ITA and be deemed sourced in Singapore. Withholding tax on payments to non-resident persons may then apply.

7.2 Payments for movie or film

7.2.1 Payment made to acquire a copy of a movie or film, say through a download or on some magnetic media, is treated as payment for a copyrighted article if the payer is not given the right to commercially exploit the movie or film. Generally, the payer acquires a copy of the movie for his private viewing and enjoyment. He is not allowed to screen the movie publicly, or to re-distribute the movie.

7.2.2 On the other hand, if the payer is a cinema operator or an airline entity that acquires the movie for the purpose of screening to its customers, the payment to the non-resident is a royalty for the use of the copyright right in the movie and is subject to withholding tax.

7.3 Payments for information (i.e. subscription payments to information providers such as Bloomberg or Lexis-Nexis)

7.3.1 Banks and research houses may pay information providers for information in order for them to service their customers. Generally, such payments allow the analysts to make use of information to support their work or generate reports for customers. The use of information is generally not considered to be commercial exploitation of the information if its use is to support the work done by the analyst and not a mere reproduction or onward distribution of the information. This means that the usage of information is limited both qualitatively and quantitatively⁶. Such payments are considered as payments for copyrighted articles.

⁶ The use of the subscription is usually governed and restricted by the terms of the agreement between an information provider and its subscribers. It is common for a subscriber to be able to quote the information in preparing its own report or analyses, or distribute a limited amount of the data or information acquired to its own customers, subject to conditions such as the subscriber may not on-licence or redistribute the databases and information provided by the information provider, the distribution of the information to the subscriber's customers must not compete with information provider's business, etc.

8 Administrative procedure

- 8.1 No approval is required for the application of the rights-based approach. To determine the correct tax treatment to be applied, taxpayers only need to ascertain the nature of payments using the rights-based approach. Proper supporting documents such as licence agreements, intercompany agreements and invoices are to be maintained and be provided to IRAS upon request. For taxpayers who wish to obtain upfront certainty on the character of any specified payments, such cases may be referred to IRAS under the Advance Ruling process.

9 Contact information

- 9.1 If you have any enquiries or need clarification on this e-Tax Guide, please call 1800-356 8300 (Individual) or 1800-356 8622 (Corporate).

Annex – Comparison of withholding tax implications

Type of Payment	Purpose	Current Treatment	Rights-Based Approach
Software payment	For the complete alienation of copyright rights in software	Owner derives business income or capital gains. Withholding tax is not applicable.	No change in tax treatment.
	For the use of software	Owner derives royalty income deemed sourced in Singapore under section 12(7)(a) of the ITA. Withholding tax applies, except for the 4 specific categories of software payments made by end-users (see paragraph 5.1.2).	Owner derives royalty income if there is a partial transfer of rights permitting the payer to commercially exploit the rights. Withholding tax applies to royalty. Where no such rights are transferred or licensed, the owner derives business income from the transfer or license of a copyrighted article. Withholding tax is not applicable.
Information and digitised goods	For the complete alienation of copyright rights in information or digitised goods	Owner derives business income or capital gains. Withholding tax is not applicable.	No change in tax treatment.
	For the use of information or digitised goods	Owner derives income from payments made for the use of or right to use movable properties or information. Such income is deemed sourced in Singapore under section 12(7)(a) or (b) of the ITA. Withholding tax applies, except where payments are made by end-users and fall within the scope of the withholding tax exemption granted (see paragraph 5.2.3).	Owner derives royalty income or income from payments made for the use of or right to use movable properties or information if the partial transfer of the rights allows the payer to commercially exploit the rights. Withholding tax applies to such payments. Where no such rights are transferred or licensed, the owner derives business income from the transfer or license of a copyrighted article. Withholding tax is not applicable.