

IRAS Consultation

**Proposed Adoption of a Rights-Based Approach
to Characterise Software Payments and
Payments for the Use of or the Right to Use
Information and Digitised Goods**



INLAND REVENUE
AUTHORITY
OF SINGAPORE

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1 Invitation To Comment

- 1.1 This Consultation Paper sets out the proposal to adopt a rights-based approach to characterise the following payments for tax purposes:
- a) payments for software, and
 - b) payments for the provision of information and digitised goods.

With the adoption of the rights-based approach, the existing withholding tax exemption regimes in relation to such payments will be removed.

- 1.2 We seek your views on whether the adoption of the rights-based approach as outlined in section 4 and the consequential removal of the existing withholding tax exemption regimes will provide greater clarity and certainty to businesses.

2 Submission

- 2.1 To facilitate review, please submit clear and succinct comments, using examples to illustrate the basis and rationale for your views and comments wherever possible. Your response should preferably not be more than four pages in length.
- 2.2 We reserve the right to make public all or parts of any written submission made in response to this Consultation Paper and to disclose the identity of the contributor. All views and comments received will be considered.
- 2.3 The closing date for submission of your views and comments is 14 May 2012. Your submission should include your name, the organization you work for or represent, your email address and telephone number. Please address your submission to :

Comptroller of Income Tax
Inland Revenue Authority of Singapore
Tax Policy & Ruling Branch
55 Newton Road
Singapore 307987

OR

Email to public_consultation@iras.gov.sg

3 Current Tax Treatment

Software Payments

- 3.1 Currently, all payments for the use of software are classified as royalty for tax purposes. Royalty made to non-resident persons are deemed to be sourced in Singapore under S12(7)(a) of the Income Tax Act (ITA). Accordingly, a payer has to withhold tax on such payments made to non-residents at the rate of 10%¹, or such reduced rate as provided under a tax treaty.
- 3.2 Withholding tax exemption² 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.
- 3.3 To qualify for the exemption, the payer must not obtain any right to exploit the copyright of the software or receive any right to duplicate copies of the software or have any right to modify, reverse engineer or decompile the software.

Payments for the Use of or the Right to Use Information and Digitised Goods

- 3.4 Payments for provision of information are payments for the use or right to use “scientific, technical, industrial or commercial knowledge”. Under S12(7)(b), such payments to non-resident persons are deemed to be sourced in Singapore and subject to withholding tax under S45A. Payments for the use or right to use digitised goods like downloadable music, movies and books may also be treated as payments under S12(7)(a) or payments for information under S12(7)(b), depending on the specific nature of the digitised goods.
- 3.5 Withholding tax exemption³ is granted to payments to non-resident persons on or after 28 February 2003 for a period of 10 years, by end-users for information⁴ and digitised goods⁵. An end-user must not acquire the right to exploit the copyright of the information or digitised goods but is only given the right to use the information or digitised goods for personal consumption. Examples of payments for information are end-user subscriptions to Bloomberg and Lexis-Nexis. Digitised goods include online or downloadable images, sound, video or text.

¹ As provided for under Section 43(3A) of the ITA.

² The withholding tax exemption was granted under S13(4) of the ITA. See 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).

³ The exemption was similarly given under S13(4) of the ITA. See 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).

⁴ For this exemption, “information” means (a) information comprised in any newspaper or magazine article or report, including financial and business data (such as foreign exchange, stock and property data) and other proprietary data and (b) information obtained solely for research purposes.

⁵ For this exemption, “digitised goods” means text, images or sounds that are transferred through any handphone, fixed-line phone, cable network, satellite, the Internet, or other form of electronic transmission.

4 **Rights-Based Approach for Characterising Payments for Software, Information and Digitised goods**

4.1 Definition of terms used

Under the rights-based approach, the characterisation of a payment is determined based on the nature of the rights transferred in consideration for the payment. In particular, it examines if the payer acquires the use of a “copyright right” or a “copyrighted article”.

a) *Copyright Right*

A transaction involves a copyright right if a payer is allowed to commercially exploit the right, typically in the following ways:

- To reproduce, modify, adapt and distribute the work to the public; or
- To prepare derivative works based upon the copyrighted software program, information or digitised good for distribution to the public.

An infringement of a copyright will occur if someone exploits the software, information or digitised good commercially without obtaining the entire rights in the copyright or a licence to do so. An example of a transaction involving a copyright right would be where a magazine editor pays to acquire the right to reproduce a copyrighted digital image that he would electronically download for the purpose of including it in a magazine issue that is to be published for sale to the public.

b) *Copyrighted Article*

A copyrighted article is transferred if the rights are limited to those necessary to enable the payer to operate the software, or use the information or digitised good for personal consumption or use within his business operations. In many instances, the user is provided merely with a *copy* of the product which he could download onto the hardware such as laptop or handphone for use. Any rights obtained to enable the user to copy the digital signal onto a media is merely an incidental part of the process in which the content is captured and stored and does not constitute a transfer of copyright right. An example of such a transaction is where a handphone user purchases a game and downloads the application onto his handphone for his personal enjoyment.

4.2 Tax treatment of copyright right vs copyrighted article

Where a payment is made in consideration for the complete alienation of the transferor's copyright right in the software, information or digitised goods, the transaction is a sale of the copyright right. Therefore, the payment would be either business income or capital gains in the hands of the transferor, depending on whether the copyright right constitutes the transferor's stock in trade.

Without a complete alienation of such copyright right as in the case where the transferor merely licenses the copyright to be exploited by different parties, such a payment is treated as royalty. If made to a non-resident person, the payment will be subject to withholding tax.

On the other hand, a payment made for the transfer of a copyrighted article is treated as business income in the hands of the transferor. As a result, payments made to non-residents for copyrighted articles will not be taxable in Singapore unless the payments constitute income derived from a trade or business carried on by the non-resident person in Singapore or income effectively connected with any permanent establishment of that person in Singapore.

4.3 Implications of adopting the Rights-Based Approach in Singapore

Adopting the rights-based approach to characterise payments for software, information and digitised goods will not result in any change in the existing tax treatment where a copyright right is alienated. Payments arising from a partial transfer of the copyright right will also continue to be treated as royalties or payments for the use or right to use movable properties or information under S12(7) of the ITA. Withholding tax under S45A remains applicable if the payments are made to a non-resident person.

In contrast, as payments for transfer of copyrighted articles are characterised as business income under the rights-based approach, they will fall outside the scope of S12(7) of the ITA. Therefore, a payer will no longer be required to withhold tax under S45A when the payment is made to a non-resident person.

The following table compares the withholding tax implications for a non-resident transferor under the current treatment and the rights-based approach.

Type of payment	Purpose	Current Treatment	Rights-based Approach
Software payment	For complete alienation of copyright rights in the software	Transferor derives business income or capital gains; Withholding tax is not applicable.	No change in tax treatment
	For use of software	Transferor derives royalty income deemed sourced under S12(7)(a) of the ITA. Withholding tax applies, except for the 4 specific categories of software payment made by end-users (see paragraph 3.2)	Transferor derives royalty income if the partial transfer of the rights permits the payer to commercially exploit the rights. Withholding tax applies to the royalty. Where no such rights are transferred, the transferor derives business income from the transfer of a copyrighted article. Withholding tax is not applicable.
Information and digitised goods	For complete alienation of copyright rights in the information or digitised good	Transferor derives business income or capital gains; Withholding tax is not applicable.	No change in tax treatment
	For use of information or digitised good	Transferor derives payment for the use of or right to use movable properties or information deemed sourced under S12(7)(a) or (b) of the ITA. Withholding tax applies, except where the payments are made by end-users and fall within the scope of the withholding tax exemption granted (see paragraph 3.5)	Transferor derives royalty income or income from the use of or right to use information or movable property if the partial transfer of the rights allows the payer to commercially exploit the rights. Withholding tax applies to the royalty. Where no such rights are transferred, the transferor derives business income from the transfer of a copyrighted article. Withholding tax is not applicable.

As can be seen from the table above, the principal difference between the two approaches lies in the distinction made in respect of copyrighted articles under the rights-based approach. However, notwithstanding the difference, the existing exemption regimes effectively afford a similar outcome as that of the rights-based approach for copyrighted articles⁶.

5 Rationale for the Proposed Adoption of the Rights-Based Approach

- 5.1 We have reviewed the current characterisation of all payments made for use of software, information and digitised goods as royalties for tax purposes in the light of rapidly changing technology and business practices.
- 5.2 While the delivery modes for software, information and digitised goods have evolved rapidly over time, the nature of rights granted to end users generally remains the same. Against such an operating environment, the current prescriptive method of exempting specific categories of royalty payments, whose descriptions may not have covered all possible intended transactions or may become outdated and require constant updating within a short period of time to keep up with rapidly changing technology and business practices, may no longer afford the same level of tax certainty needed by businesses compared to the rights-based approach.
- 5.3 Adopting the rights-based approach also aligns our tax treatment with international practices at large where such payments will be characterised based on broad principles. The move is consistent with the Government's thrust of maintaining Singapore's competitiveness as a knowledge-based economy. The approach provides for greater transparency and is less restrictive compared to the exemption-based approach. Consequently, it should help ease the compliance burden of businesses.
- 5.4 For payments made for use of software, information and digitised goods, there should be no substantive difference in tax effect to payers under the current exemption-based approach or the proposed rights-based approach. Under the current exemption-based approach, payments made by an end user to a non-resident person which do not give the end user the right to commercially exploit the copyright (including duplicating copies, modifying or adapting the software, information or digitised goods) constitute royalty payments but these payments are currently exempt from tax. As a result of the exemption, withholding tax is not applicable. Under the proposed rights-based approach, such payments will no longer be regarded as royalty payments. As a result of the characterisation of the payments,

⁶ This is because the principle underlying the withholding tax exemption for payments made for software, information and digitised goods are consistent with those applicable under the rights-based approach.

withholding tax is also not applicable on such payments. Accordingly, in both cases, the payments will not be subject to tax in Singapore⁷.

5.5 However, with the adoption of the rights-based approach for characterising software payments, as well as payments for information and digitised goods, the existing withholding tax exemption regimes for such payments will no longer be relevant. Consequently, they will be removed.

5.6 We seek your views or comments particularly in the following areas:

- a) With the proposed adoption of the rights-based approach and removal of the existing withholding tax exemptions for payments for software, information and digitised goods, do you envisage any situation where a payment covered by the existing withholding tax exemptions may become liable to withholding tax under the rights-based approach?
- b) Do you agree that the rights-based approach can be easily applied by businesses? If not, please elaborate on any practical difficulties that may be encountered by businesses in the characterisation of payments using the rights-based approach.

⁷ Except in the case 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.