

Royalty Withholding Tax & Computer Software Licence Agreements with a Non Resident

The Federal Court of Australia recently considered whether payments made from an Australian resident company to a non-resident company pursuant to a Software Licence Agreement (SLA) were liable to royalty withholding tax (RWHT). The double tax agreement (DTA) between Australia and the United States makes a payment a royalty where it is consideration for the use of, or the right to use, any copyright, patent, design, models, plans, secret formulas or process, trademarks or other like property or right.

The SLA granted certain rights and the Court considered whether these rights were for the supply of scientific, technical, industrial or commercial knowledge or information owned by any person and also whether the rights granted by the SLA were rights to use, distribute and market computer programs.

The taxpayer argued that the SLA was essentially a distribution agreement with any intellectual property rights (IP) ancillary to those essential distribution rights. The ATO argued successfully that the SLA provided the resident taxpayer rights to IP to facilitate the distribution of computer software and that these were royalties and subject to RWHT. The Commissioner's characterisation of the SLA proposed that the 'entirety of the subject matter of the SLA is the grant of IP rights, these rights being granted to the extent necessary for (the taxpayer) to carry out its function as the user, distributor and marketer of (its) goods.'

The Federal Court decided in favour of this view pursuant to the SLA's terms and conditions including that the SLA remained the same over the relevant period in question. Further, the SLA had no reference to the payments for any rights for the 'exercise of general distributorship rights. Rather, the payments are described as being for the acquisition of the stated rights. The recitals make it clear that the SLA was intended by the parties to provide flexibility to accommodate changing business offerings as a result of changing technology. The detailed definitions are consistent with the centrality to the SLA, of (the non-resident's) IP rights.'

The SLA subject matter was viewed by the Federal Court as 'the grant of IP rights rather than the grant of use, distribution and market rights.' The Court held the view that, notwithstanding the taxpayer argued that the post – contractual conduct of the parties was relevant to the construction of the SLA, there was no ambiguity in that construction and accordingly, any extrinsic evidence is inadmissible. However, the Court chose to consider this aspect as if such ambiguity was present so that 'extrinsic evidence of pre-contractual conduct and the purpose or object of the SLA would be admissible in order to establish the common intention of the parties at the time they entered into the SLA.'

In doing so, the Court stated that the taxpayer and its U.S parent have not 'pointed to any evidence of the conduct of the parties prior to entering into the SLA that supports the alternative construction that they have put forward'.

The Federal Court concluded that the full amount of the payments were 'royalties' as defined in the relevant law and subject to RWHT. It is not known whether the taxpayer intends to appeal.

***Action Point:** RWHT payers or those perhaps liable to pay, should consider the implications of this decision even though it is favourable to the ATO. It may ignite a fresh ATO policy to review taxpayers' dealings under SLAs. What was not considered in detail was how IP is delivered. ITC Group is well experienced in seeking and obtaining favourable rulings on RWHT for large corporates. In many cases, technological IT developments in the last 10 years have altered the liability for RWHT. This can favour the ability to obtain private rulings from the ATO for clients to negate RWHT liability in whole or part. Contact Steve Callanan, Director – ITC Group*

Indirect Tax News

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If you have any enquiries regarding the issues raised in this newsletter, please do not hesitate to contact one of the consultants named above.

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Land Tax – Some More Planning Points

Accountants, lawyers and specialists like ourselves often see landowners who do not wish a property sale to fall through because the prospective purchaser will not be able to obtain a sec 47 land tax clearance. Or they have suddenly been issued an assessment of up to five years of land tax on property they thought was exempt. So often the solution the landowner wants would be more easily achieved or could only have been achieved if they had put some basic planning measures in place. We list below some scenarios we see and sketch some planning ideas:

- **Two homes being a city residence and a more valuable coastal house** – you cannot simply elect that your valuable coastal retreat is your principal place of residence. You need to have compelling evidence, before the OSR arrives, that you are using and occupying it as your principal place of residence. The exemption remains possible even where you also occupy the city residence on a frequent basis.
- **Jointly owned principal place of residence** – care must be taken where one partner wishes to transfer their interest other than to their partner. We have seen several cases where, for asset protection or family law purposes, the husband has transferred his interest to a company and the principal residence exemption has been lost for the whole property.
- **Farming property** – potential exemptions for family farms are being lost as Sydney expands and voraciously consumes former farm land on its outskirts. Zoning changes mean that land which was previously exempt simply because it was used for primary production may now only be exempt if used for a primary production business. Families whose principal place of residence is elsewhere may find it best to restructure their title, ownership or use of their farm. Otherwise, their revenue from the passive holding of a token number of livestock plus any rental received from the farmhouse may be exceeded by the land tax bill on the property.

***Action Point:** Encourage clients to discuss all property dealings with you, even family & private transfers, so land tax problems can be averted. Contact Steve Baxter.*

GST – Rental of Properties Developed for Sale

The scenario is common since the GFC. A developer cannot sell his properties at an acceptable price so chooses to rent them for a period. That action will trigger an increasing adjustment eg, GST liability, in respect of the input tax credits claimed on construction. The adjustment calculations are complex and will depend on the construction arrangements, period of leasing and whether the properties are being actively marketed for sale while being rented.

***Action Point:** All developer clients need to be made aware of the potential GST liability following the decision to lease. Developers will need assistance to understand the full long term GST implications of their choice and to calculate the extremely complex adjustment calculations over 5-10 years. Contact Steve Baxter.*

DISCLAIMER

This newsletter is issued as a helpful guide. It is not intended to, and does not cover all aspects of the topics discussed. Professional advice should be sought before any action upon these topics is taken