TR 2007/D5 - Income tax: royalty withholding tax and the assignment of copyright

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Draft Taxation Ruling

Income tax: royalty withholding tax and the assignment of copyright

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What this Ruling is about

1. This draft Taxation Ruling considers the following:

   - whether an amount or amounts paid or credited as consideration for the assignment of copyright is a 'royalty' or are 'royalties' under subsection 995-1(1) of the *Income Tax Assessment Act 1997* (ITAA 1997); and
   - whether such an amount or amounts are subject to withholding tax under Division 11A of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936).

2. This draft Taxation Ruling does not apply to amounts either exempted from, or excluded by, subsections 17A(4) or (5) of the *International Tax Agreements Act 1953* (the Agreements Act) from royalty withholding tax.

3. This draft Taxation Ruling does not consider whether a royalty constitutes assessable income under sections 6-5 or 15-20 of the ITAA 1997.

4. This draft Taxation Ruling does not consider the potential application of Part IVA of the ITAA 1936 to arrangements involving the assignment of copyright.

Class of entities/scheme

5. This draft Taxation Ruling applies to non-residents who derive royalty income under the circumstances described in subsection 128B(2B) of the ITAA 1936, and to residents who derive royalty income under the circumstances described under subsection 128B(2C) of the ITAA 1936.

6. It also applies to entities or persons required under section 12-280 or 12-285 of Schedule 1 to the *Taxation Administration Act 1953* (TAA) to withhold amounts from royalties.

Background

7. The Commissioner is aware of arrangements which suggest that some non-resident copyright owners may be seeking to structure copyright transactions as assignments. The underlying rationale for this approach is the contention that payments made in respect of such assignments of copyright are not royalties and therefore would not attract royalty withholding tax.[1]

8. Subsection 995-1(1) of the ITAA 1997 defines a royalty by reference to subsection 6(1) of the ITAA 1936. Subsection 6(1) provides as follows:

> 'royalty' or 'royalties' includes any amount paid or credited, however described or computed, and whether the payment or credit is periodical or not, to the extent to which it is paid or credited, as the case may be, as consideration for:
>
> (a) the use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trademark, or other like property or right;
>
> (b) …

9. Subsection 17A(4) of the Agreements Act operates to exclude particular royalties from withholding tax where these royalties are paid to a resident of a country with which Australia has a double tax agreement and another provision[2] of the agreement excludes these particular royalties from the royalties article.

10. Taxation Ruling IT 2660 sets out the Commissioner's view in respect of the meaning given to royalties in subsection 6(1) of the ITAA 1936. Assignments of copyright in respect of computer software are covered in Taxation Ruling TR 93/12. This draft Taxation Ruling discusses assignments of copyright more generally.

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[1] See Taxation Determination TD 2006/10.

[2] For example Article 10(4) of the Singapore Agreement excludes royalties from the royalties article where those royalties are effectively connected with a trade or business carried on through a permanent establishment in Australia of a Singapore resident.

11. It is not intended in this draft Taxation Ruling to revisit the Commissioner's view of the definition of a royalty as set out in IT 2660 in any detail.

Liability for royalty withholding tax

12. A person is liable under subsection 128B(5A) of the ITAA 1936 to pay withholding tax[3] if they derive 'income' that consists of a royalty and provided the requirements of subsection 128B(2B) or (2C) of the ITAA 1936 are satisfied in relation to that income.

13. Subsection 128B(2B) of the ITAA 1936 applies to income that consists of a royalty derived by a non-resident that:

- is paid by a resident and is not an outgoing wholly incurred by the resident in carrying on business in a foreign country at or through a permanent establishment (PE) in that country (paragraph 128B(2B)(a) and subparagraph 128(2B)(b)(i) of the ITAA 1936); or
- is paid by a non-resident and is, or is in part, an outgoing incurred by the non-resident in carrying on business in Australia at or through a PE in Australia (paragraph 128B(2B)(a) and subparagraph 128B(2B)(b)(ii) of the ITAA 1936).

14. Subsection 128B(2C) of the ITAA 1936 applies to income that consists of a royalty derived by a resident of Australia in carrying on business in a foreign country at or through a PE in that country that:

- is paid by another resident and is not an outgoing wholly incurred by that other resident in carrying on business in a foreign country at or through a PE in that country; or
- is paid by a non-resident and is, or is in part, an outgoing incurred by the non-resident in carrying on business in Australia at or through a PE in Australia.

15. Under subsection 128B(5A) of the ITAA 1936 royalty withholding tax is payable at the rate declared by Parliament. That rate is currently 30% of the gross amount of royalty,[4] but it is generally reduced under Australia's double tax agreements.

16. Under section 12-280 of Schedule 1 to the TAA an entity that pays a royalty must withhold an amount from the royalty if the recipient has an address outside Australia according to the payer's records, or records kept or maintained on the payer's behalf, about the transaction, or if the payer is authorised to pay the royalty outside Australia.

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[3] Withholding tax means income tax payable in accordance with section 27GA or 128B of the ITAA 1936 (subsection 6(1) of the ITAA 1936 and section 995-1 of the ITAA 1997).

[4] Paragraph 7(c) of the *Income Tax (Dividends, Interest and Royalties Withholding Tax) Act 1974*.

17. Under section 12-285 of Schedule 1 to the TAA a person in Australia, or an Australian government agency,[5] that receives a royalty must withhold an amount from the receipt if a foreign resident is or becomes entitled to it or part of it, or to any amount of it. A person in Australia, or an Australian government agency, must similarly withhold if the foreign resident is or becomes entitled to have that person or agency credit them, or otherwise deal with on their behalf or as they direct, the royalty, part of it or any amount of it.

18. No withholding, however, is required if no withholding tax is payable on the royalty (section 12-300 of Schedule 1 to the TAA).

19. Subsection 3(8) of the Agreements Act provides that where the term 'royalties' is not defined in a double tax agreement, the expression shall, for Australian tax purposes, have the meaning it has by virtue of the definition in subsection 6(1) of the ITAA 1936.

Ruling

20. In accordance with subsections 128B(2B) and 128B(2C) of the ITAA 1936 withholding tax applies to 'income' that … 'consists of a royalty'. Subsection 128A(1AA) of the ITAA 1936 ensures that for the purposes of Division 11A and the Act imposing withholding tax the term 'income' includes a royalty. As a result, all amounts paid or credited to the copyright owner as consideration for the assignment of copyright that meet either the ordinary meaning of royalty as explained by case law[6] or the extended definition of royalty under subsection 6(1) of the ITAA 1936 will be 'income' for these purposes.

21. Any amount or amounts paid or credited as consideration for the assignment of copyright that fall within the ordinary meaning of a royalty or royalties as explained by case law are liable for withholding tax. This is regardless of whether the assignment is only a partial assignment of the copyright or whether it involves the assignment of the whole of the copyright. Such payments fall within the ordinary meaning of royalties as explained by case law, whether they are periodic or lump sum so long as they are calculated by reference to the actual or intended use of the copyright.

[5] Australian Government Agency is defined at section 995-1 of the ITAA 1997.
[6] Examples include *McCauley v. FCT* 69 CLR 235, *Stanton v. FCT* 92 CLR 630; (1955) 11 ATD 1 and *FCT v. Sherritt Gordon Mines Limited* (1977) 51 ALJR 772; (1977) 17 ALR 607; (1977) 77 ATC 4365; (1977) 7 ATR 726; (1977) 137 CLR 612.

22. Where an amount or amounts paid or credited as consideration for the assignment of copyright is not a royalty or are not royalties under the ordinary meaning as explained by case law (as referred to in paragraph 20 of this Ruling), such amount or amounts may still be a royalty or royalties under the extended meaning provided by subsection 6(1) of the ITAA 1936. In other words, the extended definition of royalties includes the ordinary meaning as explained by case law and expands upon it to include other payments made, specifically described, in respect of the use of, or right to use copyright.

23. From a taxation perspective any amount or amounts paid or credited as consideration for all forms of exploitation of the copyright short of an 'outright sale' of the copyright is a royalty or are royalties under the extended definition provided in subsection 6(1) of the ITAA 1936.[7] Such payments are regarded for tax purposes as given for the 'use of, or the right to use' copyright by the assignee.

24. Any amount or amounts paid for an outright sale of the copyright will not be a royalty or royalties and therefore, withholding tax will not be payable excepting where, as explained in paragraph 21 of this Ruling, the payment or payments fall within the ordinary meaning of a royalty or royalties as explained by case law.

25. To determine whether payments (that are not royalties under the ordinary meaning as explained by case law), are either royalties pursuant to the meaning given by subsection 6(1) of the ITAA 1936, or are for an outright sale of the copyright, it is necessary to consider all the relevant facts and circumstances surrounding the transaction including the substance of the agreement between the parties.

26. Under the *Copyright Act 1968* assignments of copyright may be limited in a number of ways,[8] including any combination of the following:

- the particular rights, that is, the right to do a class of acts, assigned;
- geographical region where the rights can be exercised; and
- time period or the number of times that the rights can be exercised.

[7] Refer paragraph 16 of IT 2660.
[8] Refer subsection 196(2) of the *Copyright Act 1968*.

27. In a taxation context, payments in respect of partial assignments (that is, assignments which are limited in any of the above ways under copyright law) are more indicative as payments for the use of, or right to use copyright and are therefore royalties. In particular, a payment for the assignment of copyright (which does not fall within the ordinary meaning of a royalty as explained by case law) that is for a term less than that of the remaining period that copyright subsists[9] is regarded as a payment for the use of, or the right to use the copyright under the extended definition in subsection 6(1) of the ITAA 1936.

28. Where consideration for the assignment of copyright is given partly as a royalty and partly as something else, only that part of the consideration that comprises the royalty component is liable to royalty withholding tax.

29. To the extent that the 'royalty' definition adopted in any tax treaty that Australia has with another country is expressed in the same terms as those in subsection 6(1) of the ITAA 1936 the views expressed in this draft Taxation Ruling on the subsection 6(1) definition apply equally to the treaty definition.

Examples

30. For simplicity, the non-residents referred to in the following examples will all be from countries with which Australia does not have a tax treaty.

Example 1

31. Ms Paparazzo is a non-resident of Australia. Ms Paparazzo is an independent journalist who carries on a business of exploiting copyright in her work. She has written a series of articles complete with photographs on a subject matter which would be of interest to the Australian public. Ozzie Publishing Ltd is an Australian resident company that publishes a number of newspapers and magazines in Australia. Ms Paparazzo assigns the Australian publishing rights of her work for a period of 6 months to Ozzie Publishing Ltd for a lump sum payment. The assignment is in writing and Ms Paparazzo supplies an invoice stating that withholding tax does not apply. The rights assigned are limited geographically to Australia and are granted for a short duration. The duration of the assignment falls significantly short of the period that copyright subsists. On expiration of the rights assigned, Ms Paparazzo would once again be able to use the underlying copyright interest in Australia. The amount is paid for the use of, or right to use copyright and is 'income that consists of a royalty'. Therefore the lump sum payment is a royalty as defined by subsection 6(1) of the ITAA 1936 and is subject to royalty withholding tax.

[9] The time period that copyright subsists is determined in accordance with sections 32 to 34 of the *Copyright Act 1968*.

Example 1(a)

32. The facts are as per Example 1 except that instead of the assignment being limited to 6 months, Ozzie Publishing Ltd can use the articles once only in three of its newspapers and once in a magazine. Upon Ozzie Publishing Ltd exercising its rights, ownership of the copyright reverts to Ms Paparazzo for the remaining period that copyright subsists. In contrast with the above example, where Ozzie Publishing Ltd is free to exercise its rights however it wishes during that limited period, there is in this scenario, a far greater limitation on its ability to use the copyright acquired. The amount paid is in relation to the use of, or right to use the articles in question. Therefore the lump sum payment is a royalty as defined by subsection 6(1) of the ITAA 1936 and is subject to royalty withholding tax.

Example 2

33. OS Computer Books Ltd is a non-resident company that publishes computer game books. OS Computer Books Ltd assigns to Aust Co Ltd, an Australian resident company, sole and exclusive rights in the copyright of a particular computer book limited to Australia, for a single lump sum payment. Aust Co is free to deal with the property as it wishes including making modifications and alterations and allowing others to use it under licence anywhere in Australia. The assignment by OS Computer Books Ltd is for the entire life of the copyright and is limited only by reference to a national geographic region (that is, the whole of Australia). The assignment, for tax purposes, is regarded as an outright sale of the Australian rights in respect of the copyright. The consideration has not been calculated by reference to the intended usage of the copyright and therefore the lump sum payment is not a royalty under the ordinary meaning as explained by case law. In addition the lump sum payment by Aust Co is not a royalty under the extended definition in subsection 6(1) of the ITAA 1936 and will not attract royalty withholding tax.

Example 2(a)

34. In relation to a particularly specialised book the same non-resident company, OS Computer Books Ltd, assigns, for the entire life of the copyright, the rights to local Australian firms limiting their rights to a specific Australian State in each case. Instead of receiving a lump sum payment, OS Computer Books Ltd receives 5% of the gross revenue generated by each assignee's use of the copyright assigned. The assignees calculate the amount payable and remit it quarterly to OS Computer Books Ltd. The periodic 5% payments by the local Australian firms constitute royalties under the ordinary meaning as explained by case law and also royalties under the extended definition provided in subsection 6(1) of the ITAA 1936. It follows that royalty withholding tax is payable.

Example 2(b)

35. The facts are as per Example 2(a) but instead of periodic payments, the local Australian firms each make a single lump sum payment calculated by reference to the population of their respective states to OS Computer Books Ltd. The lump sum payment therefore reflects the expected usage that these firms will make of the copyright and is a royalty as defined by subsection 6(1) of the ITAA 1936. Therefore it is subject to royalty withholding tax.

Example 3

36. Foreign Film Sisters Ltd (FFS), a non-resident company, owns the copyright in a feature film entitled 'Funtaxstic', which is expected to be extremely popular world wide. Australian Film Sisters Pty Ltd (AFS), a resident of Australia, is a wholly owned subsidiary company of FFS. FFS assigns the Australian theatrical film rights for Funtaxstic to AFS for 6 months for a single lump sum payment. At the date of the assignment, Funtaxstic had not yet been screened in cinemas. At the same time FFS also assigns the theatrical film rights in Funtaxstic for similar time periods to its wholly owned subsidiaries resident in other countries for screening in those respective countries. Upon expiration of the 6 month assignment, the theatrical film rights will revert to FFS although the value of the film rights will by then have been substantially exploited. In addition, it is envisaged that subsequent to the assignment of Funtaxstic's theatre film rights FFS will assign, for varying periods and with staggered commencing dates over time: the pay television rights; the video/DVD rights; and then the free to air television rights; to its wholly owned subsidiary companies around the world.

37. Notwithstanding that potentially, the majority of the theatrical film receipts will be obtained during the initial 6 month assignment when Funtaxstic is first screened in cinemas, this duration represents a relatively short period of the total life of the copyright. Funtaxstic's theatrical film rights still retain economic value and have not been completely exhausted. Inherent in the calculation of the lump sum payment to FFS is consideration of the potential gross film revenue to be earned by AFS during the period of the assignment. Pursuant to copyright law, AFS owns the Australian theatrical film rights for the period of the assignment. The substance of the transaction for taxation purposes is that AFS has obtained by its payment to FFS, the use of, or rights to screen Funtaxstic in Australia for a limited period of 6 months. From FFS's perspective, it has retained a significant interest in the film's copyright whilst assigning AFS the right to screen Funtaxstic in Australia for a period of 6 months. The lump sum payment is considered to be a royalty under the extended definition provided in subsection 6(1) of the ITAA 1936 and is therefore subject to royalty withholding tax.

Example 3(a)

38. The facts are as per Example 3, however instead of the assignment being for a limited period of 6 months, the assignment of the theatrical film rights is for the entire remaining life of the copyright. As part of the arrangement, upon the assignment taking effect, FFS also enters into a 'forward purchase contract' with AFS. Under this additional agreement AFS agrees to assign the theatrical film rights in Funtaxstic back to FFS at the expiration of 6 months. In substance, this arrangement has the same effect as the above example. That is, the payment is in respect of the use of, or right to use the copyright. As a consequence the lump sum payment by AFS in this example is also a royalty under the extended definition provided in subsection 6(1) of the ITAA 1936 and is therefore subject to royalty withholding tax.

Example 3(b)

39. Following on from Example 3 above, at the expiration of the 6 month theatrical film copyright assignment, FFS assigns for the remaining period that copyright subsists, and for a single lump sum payment, the Australian video/DVD rights for Funtaxstic to AFS. The assignment is not limited by time and there are no reversionary rights to FFS. AFS is free to exploit the video/DVD rights without restriction in Australia for the remaining period that copyright subsists. The lump sum payment is given for an outright sale of the Australian video/DVD rights. The payment is not calculated by reference to the intended usage of the rights to be exercised by AFS and therefore is not a royalty under the ordinary meaning as explained by case law. The payment is not a royalty under subsection 6(1) of the ITAA 1936 and therefore no royalty withholding tax is payable.

Date of effect

40. It is proposed that when the final Ruling is issued, it will apply both before and after its date of issue. However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
27 June 2007

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

41. A withholding tax liability will arise in respect of a payment for the assignment of copyright, if the payment falls within the definition of a royalty pursuant to subsection 6(1) of the ITAA 1936. Subsection 6(1) includes amounts that are considered to be royalties under the ordinary meaning of the term (as explained by case law) but also extends the meaning to include other amounts specifically described. This explanation considers whether payments for the assignment of copyright are royalties, firstly under the ordinary meaning as explained by case law and secondly under the extended definition. It then distinguishes royalty payments from those that are given for an outright sale of the copyright. To undertake this analysis, it is appropriate to briefly discuss the following relevant concepts in the context of intellectual property rights:

- copyright;
- assignment; and
- assignment of copyright.

Copyright

42. Intellectual property rights such as copyright are a form of personal property, being in the nature of exclusive rights to use or prohibit others from using the underlying invention or work.

43. Butterworths Australian Legal Dictionary (1997) defines 'copyright' at page 282 as follows:

> Intangible property which allows the copyright owner, or those authorised by the copyright owner, the exclusive right to prohibit or to do certain acts. The rights comprised in the copyright are distinct from any rights adhering in the medium in or upon which the relevant work or subject matter is recorded: for example *Pacific Film Laboratories Pty Ltd v. FCT* (1970) 121 CLR 154.

44. Section 31 of the *Copyright Act 1968* specifies the nature of copyright in this way:

> (1) For the purposes of this Act, unless the contrary intention appears, copyright, in relation to a work, is the exclusive right:
>
> (a) in the case of a literary, dramatic or musical work, to do all or any of the following acts:
>
> (i) to reproduce the work in a material form;
>
> (ii) to publish the work;
>
> (iii) to perform the work in public;

(iv) to broadcast the work;

(v) to cause the work to be transmitted to subscribers to a diffusion service;

(vi) to make an adaptation of the work;

(vii) to do, in relation to a work that is an adaptation of the first-mentioned work, any of the acts specified in relation to the first-mentioned work in subparagraphs (i) to (v) inclusive; and

(b) in the case of an artistic work, to do all or any of the following acts:

(i) to reproduce the work in a material form;

(ii) to publish the work;

(iii) to include the work in a television broadcast;

(iv) to cause a television programme that includes the work to be transmitted to subscribers to a diffusion service.

45. Whilst there are exceptions, generally speaking copyright subsists for a period of 70 years from a reference point as determined under the *Copyright Act 1968*.[10]

46. The essence of copyright is that it creates exclusive rights to exploit or use the underlying literary, dramatic or musical work. It follows that many concepts applicable to real property where there is a clear distinction between the property itself and the use thereof, are not appropriate in the field of intellectual property.

Assignment

47. Under subsection 196(1) of the *Copyright Act 1968,* copyright may be transferred by assignment, by will and by devolution by operation of law. An assignment of copyright will transfer the rights to use the literary, dramatic or musical work such as by way of publication, performance, broadcasting etc. Simply stated, 'assignment' means:

> A transfer of rights or liabilities such as those that arise under an instrument, chose in action or debt.[11]

This draft Taxation Ruling proceeds on the premise that an effective assignment has been made. That is, one which terminates the copyright owner's (the assignor's) interest in the copyright and transfers that interest to another (the assignee).

[10] Sections 32 to 34 of the *Copyright Act 1968*.
[11] Butterworths Australian Legal Dictionary 1997 at page 79.

Assignment of copyright

48. Subsection 196(2) of the *Copyright Act 1968* provides for the partial assignment of copyright as follows:

> An assignment of copyright may be limited in any way, including any one or more of the following ways:
>
> (a) so as to apply to one or more classes of the acts that, by virtue of this Act, the owner of copyright has the exclusive right to do (including a class of acts that is not separately specified in this Act as being comprised in the copyright but falls within a class of acts that is so specified);
>
> (b) so as to apply to a place in or part of Australia;
>
> (c) so as to apply to part of the period for which the copyright is to subsist.

49. By way of example, the copyright in feature films[12] may often be divided into separate rights, that is, theatrical/cinema release, pay television, video/DVD rental and sales, and free to air television. Each of these separate rights are commonly then exploited for limited periods over time in respect of specific geographical areas.

50. Section 30 of the *Copyright Act 1968* in conjunction with section 196 of the *Copyright Act 1968*, enables the owner of copyright to fully or partially transfer copyright ownership for a given period to another by assignment. Section 30 confers ownership of the particular rights assigned to the assignee. Where a partial assignment is made, the transfer of ownership is limited to that part of the copyright assigned with the effect that the assignor retains an ownership interest in the residual part or parts of the copyright not assigned. Continuing with the above example, a film's owner (the assignor) could assign the theatrical film rights to two separate cinema chains in Australia for a period of 6 months for screening in distinct geographical areas. In doing so, the assignor would retain an ownership interest in the copyright and would be free to assign similar rights outside of Australia during the same 6 month period. Further, during the same 6 month period or subsequently, the assignor would also be free to assign other classes of rights, for example video/DVD rights in the film in Australia or overseas. Upon the expiration of the 6 month period, full ownership will once again rest with the assignor for the remaining period that copyright subsists.

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[12] Section 86 of the *Copyright Act 1968* lists the nature of copyright in cinematograph films as follows:
For the purposes of this Act, unless the contrary intention appears, copyright, in relation to a cinematograph film, is the exclusive right to do all or any of the following acts:
(a) to make a copy of the film;
(b) to cause the film, in so far as it consists of visual images, to be seen in public, or, in so far as it consists of sounds, to be heard in public;
(c) to communicate the film to the public.

51. As explained in paragraph 47 of this Ruling, under the *Copyright Act 1968* an assignment of copyright transfers ownership of the copyright from the assignor to another (the assignee). However, the fact that ownership of copyright has been transferred by an assignment is not a determinative factor in characterising any respective payment made by the assignee in a taxation law context. In considering the meaning of the defined term 'royalty' or 'royalties' under the ITAA 1936, different issues arise. From a taxation perspective, the matter turns upon an examination of all relevant facts and circumstances concerning the assignment in order to ascertain whether the consideration given is for 'the use of' or 'the rights to use' the intellectual property in question.

52. Given the multiplicity of ways in which agreements affecting copyright may be expressed, the terms adopted by the parties (such as 'sole right' or 'sole and exclusive right', 'assignor' and 'assignee' or 'licensor' and 'licensee') are not necessarily determinative of the true nature of the agreement in a taxation context.[13]

Whether the amount or amounts paid or credited as consideration for the assignment of copyright is a royalty or are royalties within the ordinary meaning as explained by case law

53. Authors and writers of books, novels or articles commonly deal with their work by assigning copyright to publishers in return for the payment of royalties. Indeed in *Barker v. Stickney* [1919] 1 KB 121 (CA) Scrutton LJ at page 133 noted:

> a usual way of publishing books is to assign the copyright in consideration of royalties.

54. The English High Court of Justice (King's Bench Division) in *The Commissioners of Inland Revenue v. Longmans Green & Co Ltd* 17 TC 272 considered the nature of a lump sum payment for the exclusive right to translate a book written in French into English and to publish 28,000 copies of the book. The book failed to sell as anticipated and ultimately only 7,000 copies were printed. The payment was held to be royalty income, per Finlay J at pages 283 to 284:

> I think that the true view is that, as to the whole, this was a sum payment for or on account of royalties in respect of this book. It seems to me that what they did was, so to speak, to quantify, fix a sum for, the royalties in respect of 28,000 copies, but, none the less, one can see from the agreement itself that the sum was a – sum in respect of royalties. I was referred to several cases; none I think throws any very great light on the matter. *Constantinesco v. Rex*, in 11 TC 730, and *Mills v. Jones*, in 14 TC 769, were referred to. I do not think that these cases have any very direct bearing, but they do undoubtedly show this, that the circumstance that there is one lump sum paid is not in any way decisive to show that this is not paid in respect of royalties. As one of the Lord Justices, I think pointed out, it does not matter whether you have got a lump sum paid every year

[13] *Cliffs International Inc v. FCT* 79 ATC 4059 per Barwick CJ at page 4064.

> or a sum paid every three years, or even a lump sum paid once and for all; you have to look at the substance of the thing and arrive at a conclusion as to whether in truth the sum was paid in respect of royalties.

55. As noted by Lord Denning MR in *Murray (Inspector of Taxes) v. Imperial Chemical Industries Ltd* [1967] 2 All ER 980 at pages 982 to 983:

> …. But it seems to me fairly clear that if, and in so far as, a man disposes of patent rights outright (for example, by an assignment of his patent, or by the grant of an exclusive licence) and receives in return royalties calculated by reference to the actual user, the royalties are clearly revenue receipts. If and in so far as he disposes of them for annual payments over the period, which can fairly be regarded as compensation for the user during the period, then those also are revenue receipts (such as the payment of £2,500 a year over ten years in Inland British Salmson Case).

56. In the case cited above, Lord Denning was referring to the outright disposal of patent rights (by assignment or by the grant of an exclusive licence) but it is equally applicable to the outright transfer of copyright. Consideration given in the form of ordinary meaning royalties as explained by case law are payments for the rights to publish, perform etc the original work and are calculated by reference to quantity or value or the occasions on which the particular rights are exercised.[14]

57. Such amounts are usually periodic payments, payable as and when the right acquired is exercised. However, a lump sum payment is a royalty where it is a pre-estimate or an after the event recognition of the amount of use made of the right acquired. The key characteristics of a royalty under the ordinary meaning as explained by case law are discussed in greater detail in IT 2660.

58. Any amounts paid or credited as consideration for the assignment of copyright that fall within the ordinary meaning of a royalty or royalties as explained by case law (and therefore the extended subsection 6(1) of the ITAA 1936 definition) are liable to withholding tax where the provisions in subsection 128B(2B) or subsection 128B(2C) of the ITAA 1936 are satisfied.

Whether the amount or amounts paid or credited as consideration for the assignment of copyright is a royalty or are royalties under the extended definition in subsection 6(1) of the ITAA 1936

59. Where the amount or amounts paid or credited as consideration for the assignment of copyright is not a royalty, or are not royalties within the ordinary meaning as explained by case law, they could still fall within the scope of the extended meaning of royalties provided under subsection 6(1) of the ITAA 1936.

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[14] *Stanton v. FCT* (1955) 11 ATD 1 at 4; (1955) 92 CLR 630 at 642 and *FCT v. Sherritt Gordon Mines Ltd* 77 ATC 4365 at 4372; (1977) 137 CLR 612 at 626-627.

60. In *Case U33* 87 ATC 250; (1987) 18 ATR 3194, the taxpayer granted an exclusive licence and a non-exclusive licence in relation to lawn edgers for full term of the Letters Patent, the consideration being royalties of 15 US cents for each lawn edger made or sold and a non-refundable advance against those royalties of US$10,000. The licensee corporation was dissolved and it appeared that no lawn edgers were manufactured or sold. The Tribunal held that while the lump sum payment of US$10,000 was not a royalty within the ordinary meaning (as it was not made in respect of the particular exercise of the invention and was not calculated by reference to the occasions upon which the right was to be exercised), it nevertheless was within the extended meaning of royalty given by subsection 6(1) of the ITAA 1936, subparagraph (a), being:

> …any amount paid or credited, …, as consideration for – the right to use, any…, patent.

61. In *FCT v. Franklin Mint Pty Ltd* (1993) 116 ALR 240; (1993) 93 ATC 4637; (1993) 26 ATR 248; (1993) 44 FCR 109, the Full Federal Court considered the meaning of royalty as defined in subsection 3A(5) of the *Sales Tax Assessment Act (No. 1) 1930* (STAA No. 1).[15] The Court had to consider whether a licence fee paid for the use of trademarks and get up was a royalty under the STAA No. 1. The Court found that the flat annual fee payable irrespective of the value of products sold or the use made of the trademarks and get up, did not fall within the ordinary meaning of royalty but did fall within the extended sales tax definition. In a joint judgment, the Court held at ATC 4646 to 4647 that:

> An amount may answer the description in sub-s. 3A(5) of royalty, howsoever described or computed and whether paid periodically or not, provided that it is royalty as understood at general law, or a "like payment". Thus, a sum for the use of trade marks for a particular period may be paid by way of like payment to a royalty, within the meaning of the sub-section, even though it is described in the relevant agreement as a fee rather than a royalty, and it is paid not periodically but in one lump sum. The payment is made as consideration for the use or right to use a trade mark within the meaning of sub-s. 3A(5)(c), in conjunction with the meaning of 'trade mark' given by para. 3A(7).
>
> In our view there is no surplusage in the second use of the term "royalty" in the opening words of sub-s. 3A(5). An amount which answers the description of a royalty as established by the High Court decisions will fall within the operation of the sub-section. Further, an amount will be a "like payment" and therefore a "royalty" within the meaning of the sub-section, to the extent to which it is paid as consideration for any of the matters described in sub-paras. (a)-(f). This will be so even though, for example, it would not be a royalty as ordinarily understood because it was paid by way of total or partial forbearance of user of a patent design or trade mark. If the amount otherwise answers the expanded description of a like payment, it is no answer that the payment is not periodical.

[15] Note that subsection 3A(5) of the STAA No. 1 was expressed in terms similar to that of subsection 6(1) of the ITAA 1936.

> If the provision is construed in the manner we have described, then it follows that the licence fee payment in question fell within the operation of the provision.

62. If, having regard to the substance of the contract, a payment falls within the subsection 6(1) definition, it will be a royalty whether paid in a lump sum or periodically. Unlike the ordinary meaning of royalty as explained by case law, it is not necessary for the payment to be calculated by reference to the degree of use of the copyright. That is, a payment which in substance is for the use of, or right to use the copyright, even where that right is not exercised, will be a royalty. The form of the payment and the way in which it is computed is not conclusive in determining whether or not the payment is a royalty under the extended meaning given by subsection 6(1) of the ITAA 1936.

Whether the amount or amounts paid or credited as consideration for the assignment of copyright constitute a 'royalty' or 'royalties' for the purposes of section 6(1) of the ITAA 1936, or are for an 'outright sale of the copyright'

63. In respect of consideration given for the assignment of copyright only amounts that relate to the 'use of' or a 'right to use' the intellectual property rights will qualify as a royalty under the extended meaning of royalties given by subsection 6(1) of the ITAA 1936 and are liable to withholding tax.

64. Distinguishing between payments that are royalties and payments for the outright sale of copyright for taxation purposes depends upon the facts of each case. In this respect, it is necessary to carefully construe the terms of the agreement between the parties and characterise the consideration by reference to the substance of the agreement.

Partial assignments and complete assignments

65. Where the assignment is limited in any respect, it will be a partial assignment of the copyright. That is, the assignment is not total and the assignor retains ownership of that part of the copyright not assigned. The assignee has obtained a right to use the copyright in respect of the rights assigned under the partial assignment and only for the period thereof.

66. As outlined in paragraphs 48 to 50 of this draft Taxation Ruling, assignments may be limited in a number of ways including any combination of the following:

- the particular classes of rights assigned;
- geographical region where the rights can be exercised; and
- time period or the number of times that the rights can be exercised.

67. In a taxation context payments made for partial assignments are more indicative as being payments for the use of, or right to use copyright and therefore are royalties. Further, the more limited the assignment, the more likely the payment is considered to be for the use of or right to use the copyright. In particular, in respect of assignments limited by time, where the period of the assignment is less than the remaining period that copyright subsists, the payment made is regarded as for the use of, or right to use the copyright as opposed to an outright sale.

68. Once and for all lump sum payments for the assignment of copyright which are not limited in any respect (that is, for all classes of acts world wide in relation to the copyright and for the total remaining period that copyright subsists) are not royalties for tax purposes. Such a transaction involves an outright sale of the copyright involved.

Consideration given partly as a royalty

69. There are cases where consideration for the copyright assignment is given by way of a lump sum or lump sums together with periodic payments calculated by reference to the degree of use of the rights. The meaning given to royalty by subsection 6(1) of the ITAA 1936 requires the dissection or apportionment of a consideration given partly as a royalty and partly as something else. Such a dissection or apportionment would need to be determined on a reasonable basis having particular regard to the facts and circumstances surrounding the case in question. Only the royalty component of the consideration is liable to royalty withholding tax.[16]

[16] Refer IT 2660, paragraph 13.

Appendix 2 – Your comments

70. We invite you to comment on this draft Taxation Ruling. Please forward your comments to the contact officer by the due date. (Note: The Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel or relevant Tax officers. The Tax Office may use a version (names and identifying information removed) of the compendium in providing responses to persons providing comments. Please advise if you do not want your comments included in the latter version of the compendium.)

Due date:	**10 August 2007**
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Appendix 3 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

IT 2660; TR 93/12; TR 2006/10; TD 2006/10

Subject references:

- economic rights & entitlements
- non resident royalty withholding tax
- ownership, interests, control & rights
- royalties

Legislative references:

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- ITAA 1997 6-5
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- Income Tax (Dividends, Interest and Royalties Withholding Tax) Act 1974 7(c)
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- Cliffs International Inc v. FCT (1979) 53 ALJR 321; (1979) 24 ALR 57; (1979) 79 ATC 4059; (1979) 9 ATR 507; (1979) 142 CLR 140
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- Mills v. Jones 14 TC 769
- Murray (Inspector of Taxes) v. Imperial Chemical Industries Ltd [1967] 2 All ER 980
- Pacific Film Laboratories Pty Ltd v. FCT (1970) 121 CLR 154
- Stanton v. FCT 92 CLR 630; (1955) 11 ATD 1
- The Commissioners of Inland Revenue v. Longmans Green & Co Ltd 17 TC 272

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