TR 2008/7 - Income tax: royalty withholding tax and the assignment of copyright

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Taxation Ruling

Income tax: royalty withholding tax and the assignment of copyright

Contents Para

LEGALLY BINDING SECTION:

What this Ruling is about 1

Ruling 11

Examples 35

Date of effect 56

NOT LEGALLY BINDING SECTION:

Appendix 1:

***Explanation* 57**

Appendix 2:

***Discussion of Canadian cases* 128**

Appendix 3:

***Alternative views* 133**

Appendix 4:

***Detailed contents list* 135**

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This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

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If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling considers whether an amount paid or credited as consideration for the assignment of copyright is subject to royalty withholding tax under section 128B of the *Income Tax Assessment Act 1936* (ITAA 1936).

2. This Ruling does not consider:

- whether such an amount constitutes assessable income under section 6-5 or 15-20 of the Income Tax Assessment Act 1997 (ITAA 1997).
- the potential application of Part IVA of the ITAA 1936 to arrangements involving the assignment of copyright.
- other transactions in relation to copyright, such as the grant of a licence in respect of a copyright.

3. Different definitions of 'royalties' apply depending upon which particular foreign country is relevant. The Ruling covers the following five topics:

- Payments made to residents of countries with which Australia has a tax treaty that defines 'royalties' in the most usual way;
- Payments made to residents of the USA and Mexico, tax treaties which have a slightly different definition of 'royalties';

- Payments to which no tax treaty applies;
- Apportionment of payments that are partly royalties; and
- PAYG withholding obligations.

Class of entities/scheme

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

5. 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.

Definitions

crediting of amounts

6. To avoid repetition, further references in this Ruling to a payment should be taken to include a reference to a crediting.[1]

'tax treaty'

7. In this Ruling, 'tax treaty' means a comprehensive agreement given the force of law in Australia by the *International Tax Agreements Act 1953* (the Agreements Act).[2]

'standard tax treaty definition'

8. In this Ruling, the expression 'standard tax treaty definition' of 'royalties' refers to any definition of 'royalty or royalties'[3] found in a tax treaty that includes a provision in the same, or substantially the same, terms as the following:

> payments or credits, whether periodical or not, and however described or computed, to the extent to which they are made 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; …[4]

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[1] All the relevant definitions of 'royalty' in legislation and treaties apply to the crediting of amounts in the same way as they apply to actual payments.
[2] For more detail concerning the Commissioner's general approach to interpretation of tax treaties see Taxation Ruling TR 2001/13.
[3] Hereinafter, for simplicity the term 'royalty or royalties' will be referred to as royalties.
[4] This version of the definition is sourced from paragraph (3) of Article 12 of the 2006 Finnish Agreement as set out in Schedule 22 to the Agreements Act.

9. The only tax treaties where the definition materially varies from the standard tax treaty definition are the USA and Mexican tax treaties.[5] The significance of this variation is discussed specifically below.

'domestic tax law definition'

10. In this Ruling, a reference to the domestic tax law definition of 'royalties' is a reference to the definition of that term in subsection 6(1) of the ITAA 1936.

Ruling

Tax treaty situations – standard tax treaty definition

11. This section of the Ruling applies where a recipient beneficially entitled to the payment for the assignment of copyright is a resident of a country with which Australia has a tax treaty in force under the Agreements Act.

12. All amounts paid as consideration for an assignment of copyright are royalties under the standard tax treaty definition of that term unless the assignment is properly characterised as an outright sale of the copyright.[6]

13. This is a question of determining, in light of the definition of 'royalties', and having regard to all relevant facts and circumstances, whether the payment is to be regarded as a payment for the sale of property consisting of the copyright or as a payment for the use of, or the right to use, that property. 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 arrangement.

14. The Commissioner accepts that an assignment of copyright amounts to an outright sale if:

- it is for the full remaining life of the copyright; and
- it extends geographically over an entire country or several entire countries; and
- it is not limited as to the class of acts that the copyright assignee has the exclusive right to do; and
- the amount and the timing of the payment or payments for the assignment are not dependent on the extent of exploitation of the copyright by the assignee.

[5] Schedules 2 and 47 respectively of the Agreements Act, hereinafter referred to as the US and Mexican tax treaties.
[6] See paragraph 16 of Taxation Ruling IT 2660.

15. The Commissioner does not accept that any payment made in consideration for an assignment of copyright automatically falls outside the standard tax treaty definition of 'royalties' merely because, as a matter of copyright law, the transaction is an assignment of the owner's interest in the copyright, rather than, say, a grant of a licence in respect of that copyright.[7] If the other indications are that the payment can more accurately be described as for the use or the right to use the copyright then the payment is a royalty.

16. Within the spectrum of arrangements bounded by these two scenarios, difficult questions of degree can arise. The Commissioner's view is that the expression 'payment for the use of, or the right to use' a copyright captures all payments made in consideration for an assignment of copyright unless the assignment is, having regard to the following factors, more comparable to an outright sale of the copyright than to the grant of a right to use the copyright:

- the duration of the assignment as compared with the actual or estimated legal life of the copyright;
- the geographical extent of the assignment;
- any limitation on the assignment as to the class of acts that the copyright assignee has the exclusive right to do;
- whether the amount and the timing of the payments are dependent upon or determined by the exploitation of the copyright by the assignee.

17. As for the first factor, if an assignment is for the period equal to the remaining underlying legal life of the copyright this would point towards (though not conclusively establish) an outright sale. Conversely, if an assignment is for significantly less than the remaining underlying legal life of the copyright, this would point toward the opposite conclusion.

18. As for the second factor, an assignment covering all of Australia (or all of some other country) would be consistent with the concept of an outright sale (though not enough by itself to establish that conclusion). An assignment covering only some local area would be indicative of a payment for use or the right to use.

19. As for the third factor, an assignment covering a whole class of possible exploitation of the copyright would be consistent with the concept of an outright sale (though not enough by itself to establish that conclusion). For example, all cinematic exploitation of a film would be in this category. A more limited assignment would be indicative of a payment for use or the right to use.

[7] The Commissioner has consistently interpreted the definition of royalties in a manner whereby the answer to an arrangement is not determined solely by reference to the legal form of a transaction: Taxation Determination TD 2007/31, Taxation Ruling TR 98/21 and Taxation Ruling TR 2003/2.

20. As for the fourth factor, the standard tax treaty definition covers all payments 'whether periodical or not, and however described or computed'.[8] The Commissioner does not interpret this as denying any relevance to the way in which a particular payment for an assignment is computed. Rather, the tax treaty definition by these words makes it clear that the definition is capable of extending to payments that are not computed on the basis of the extent or the timing of the exploitation of the copyright in the hands of the payer. However where the assignment is limited and the payment is clearly structured by reference to the use, this positively points towards a conclusion that the transaction is for the use of, rather than the ownership of, the copyright.

The US and Mexican tax treaties

21. Australia's agreement with the United States[9] contains the standard tax treaty definition at subparagraph (4)(a) of Article 12, with the exception that, instead of the expression 'whether periodical or not, and however described or computed', payment or credits 'of any kind' are specified. Subject to that difference, the above section on the standard treaty definition therefore applies to payments to which US residents are beneficially entitled so far as subparagraph (4)(a) is concerned.

22. The Commissioner interprets the use of the phrase 'of any kind' instead of 'whether periodical or not, and however described or computed' as giving rise to no material difference in the scope of the definition.

23. At subparagraph (4)(c) of that Article the US tax treaty also includes the following category of payment within its definition of 'royalties':

> (c) income derived from the sale, exchange or other disposition of any property or right described in this paragraph to the extent to which the amounts realized on such sale, exchange or other disposition are contingent on the productivity, use or further disposition of such property or right.

24. This means that, even if a payment to which a US resident is beneficially entitled from the assignment of copyright is characterised as being for an outright sale and hence is not a royalty under subparagraph (4)(a), it is still a royalty under the US tax treaty to the extent to which the amount of the payment depends on the productivity, use or further disposition of the copyright.

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[8] The US tax treaty does not have these words: see subparagraph (4)(a) of Article 12 (Schedule 2 of the Agreements Act), as amended by Article 8 of the Protocol to the Convention (Schedule 2A of the Agreements Act).
[9] See Schedule 2 to the Agreements Act.

25. Paragraph (4) of Article 12 of the Mexican tax treaty is an almost identically worded provision corresponding to subparagraph (4)(c) of the US Convention. As such it has an identical application in relation to payments dealt with by the Mexican tax treaty as per the explanation at paragraph 24 of this Ruling.

Domestic tax law situations

26. This section of the Ruling applies to payments in respect of assignments of copyright if no tax treaty is relevant to the transaction (that is because the payee is not a resident of a foreign country with which Australia has a tax treaty).

27. A payment that is a royalty under the standard tax treaty definition according to the principles in paragraphs 11 to 20 of this Ruling is also a royalty in this situation because paragraph (a) of the definition of 'royalty' in subsection 6(1) of the ITAA 1936 is in substantially the same terms as the standard tax treaty definition. The Commissioner's view is that paragraph (a) should be interpreted in accordance with the equivalent expression in the standard tax treaty definition.

28. However, in addition, a payment which does not satisfy paragraph (a) of the definition of 'royalty' in subsection 6(1) of the ITAA 1936 can still be a royalty within the ordinary meaning of that term as explained by case law.[10]

29. As the only payments in consideration for an assignment of copyright that do not satisfy paragraph (a) of the definition of 'royalty' in subsection 6(1) of the ITAA 1936 are those for an outright sale, the sole issue under the ordinary meaning of royalty is whether a payment for an outright sale is caught.

30. The Commissioner's view is that payments for an outright sale of a copyright would be a royalty within the case law meaning to the extent that the amount of the payments are determined by reference to the use of the copyright. Normally such payments would be made periodically but a lump sum payment may be a royalty within the ordinary meaning if it is a pre-estimate (as opposed to a non-refundable advance) or an after-the-event recognition of the actual extent of the copyright's use on the part of the assignee.[11]

Payments that are partly royalties

31. In all cases, if 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 subject to royalty withholding tax.

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[10] See *McCauley v. FCT* (1944) 69 CLR 235; (1944) 7 ATD 427, *Stanton v. FCT* (1955) 92 CLR 630; (1955) 11 ATD 1 and *FCT v. Sherritt Gordon Mines Limited* (1977) 137 CLR 612; 77 ATC 4365; (1977) 7 ATR 726.

[11] See paragraph 10(d) of Income Tax Ruling IT 2660.

PAYG withholding

32. An entity that pays an amount that is a royalty (within the relevant meaning of that term as explained by this Ruling) must withhold an amount from the payment 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.[12]

33. A person in Australia, or an Australian government agency,[13] that receives an amount that is a royalty within the relevant meaning given by this Ruling 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.[14]

34. No withholding, however, is required if withholding tax is not payable on the royalty.[15]

Examples

35. To simplify matters it is assumed that none of the persons in any of the following examples are carrying on a business at or through a permanent establishment in any country other than their country of residence.

Example 1

36. Ms Paparazzo is a resident of the US (with which Australia has a tax treaty). She is an independent photographer who carries on a business of exploiting copyright in her work. She has taken a photograph of a popular Hollywood celebrity remonstrating angrily with a waiter at a fashionable Los Angeles restaurant. Ozzie Publishing Ltd is an Australian resident company that publishes a number of newspapers and magazines in Australia.

37. Ms Paparazzo assigns all the Australian publishing rights in respect of the photograph for a period of 6 months to Ozzie Publishing Ltd in return for a lump sum payment. The rights assigned are limited by time and are limited geographically to Australia.

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[12] Section 12-280 of Schedule 1 to the TAA.
[13] Australian Government Agency is defined at section 995-1 of the ITAA 1997.
[14] Section 12-285 of Schedule 1 to the TAA.
[15] Section 12-300 of Schedule 1 to the TAA.

38. Having regard to the factors set out in paragraphs 16 to 20 of this Ruling, this assignment is not an outright sale of the Australian publishing rights. It is a payment for use of the Australian copyright in accordance with the standard tax treaty definition and is therefore a royalty. The critical feature is that the limited duration of the assignment falls significantly short of the period for which copyright subsists.

39. The payment is a royalty within the meaning of the US tax treaty and therefore royalty withholding tax is payable.

Example 1(a)

40. The facts are as per Example 1 except that instead of the assignment being limited to 6 months, Ozzie Publishing Ltd can use the photograph once only in three of its newspapers and once in a magazine.

41. Assume for the purposes of this example that, based on these facts, an effective assignment for copyright law purposes has occurred. Nevertheless, the additional contractual conditions imposed on Ozzie Publishing Ltd in relation to its use of the copyright are so restrictive that the arrangement between the parties is more accurately characterised for tax purposes as the mere grant of rights to use, rather than a sale of, the copyright itself. Accordingly the payment is a royalty with effect that royalty withholding tax is payable.

Example 2

42. OS Computer Books Ltd is a company resident in New Zealand that publishes computer game books. OS Computer Books Ltd assigns to Aust Co Ltd, an Australian resident company, all its rights in the copyright of a particular computer book limited to Australia, for a single lump sum payment which is not dependent on any actual use of the copyright. Aust Co Ltd 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).

43. Australia has a tax treaty with New Zealand. For the purposes of the standard tax treaty definition of ‘royalties’, as all factors point to this assignment being comparable to an outright sale rather than a right to use the copyright, no royalty withholding tax is payable.

Example 2(a)

44. The facts are as per Example 2, however instead of receiving a lump sum payment, OS Computer Books Ltd receives 5% of the gross revenue generated by Aust Co Ltd's use of the copyright. Aust Co Ltd calculates the amount payable and remits it quarterly to OS Computer Books Ltd. The payments in respect of the copyright are calculated by reference to use.

45. This particular mode of payment is not enough to alter the conclusion that an outright sale has occurred. No royalty withholding tax is payable.

Example 2(b)

46. The facts are as per Example 2(a) except that OS Computer Books Ltd is a resident of a country with which Australia does not have a tax treaty. Therefore the domestic tax law definition of royalties is relevant to the analysis.

47. In this case, although still an outright sale, because all of the payments are calculated by reference to the extent of the actual exploitation of the copyright, the payments are royalties within the case law meaning[16] of royalties and therefore the inclusive definition at section 6(1) of the ITAA 1936. Royalty withholding tax is therefore payable.

Example 3

48. Foreign Film Sisters Ltd (FFS), a company resident in Canada (with which Australia has a tax treaty), 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. Whilst the Australian theatrical film rights are expected to be substantially exploited during this period, the film will probably continue to be shown in some Australian cinemas to a lesser extent for some time after this limited assignment. Note however, that FFS would have to grant further rights in relation to Australia for this to occur.

[16] Although not directly dealt with by Australian cases, in *Barker v. Stickney* [1919] 1 KB 121 Scrutton LJ stated at 133 'a usual way of publishing books is to assign the copyright in consideration of royalties'.

49. In addition, it is planned that after the assignment of Funtaxstic's theatrical film rights, FFS will assign to its wholly owned subsidiary companies around the world, 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.

50. In relation to the relevant factors, the assignment of copyright to the Australian company is not in respect of all Australian rights, but is limited to the theatrical rights only. Separate contracts will be entered into between the same parties in relation to assigning other classes of rights in respect of the copyright subsisting in this film. However the time period for which copyright is assigned for each class of right represents a very short period of the total life of the copyright in the film.

51. On balance, the terms of the contract of assignment significantly limited by time and class of right impose a real restriction on the use of the copyright by the assignee. In a tax context this points towards treating the payment as a royalty rather than as an outright sale of the copyright. Accordingly, the lump sum payment is considered to be a royalty under the standard tax treaty definition and is therefore subject to royalty withholding tax.

Example 3(a)

52. Whilst otherwise similar to Example 3, FFS instead partially assigns the theatrical film rights to individual cinemas for the geographical area including and immediately surrounding the location of each cinema for the entire life of the theatrical film rights. Whilst the rights granted for the life of the copyright are generally an indicator of an outright sale, the extremely restrictive geographic limitation severely limiting the use that may be made by the specific copyright owners produces an opposite conclusion. A partial assignment with this degree of restriction is not an outright sale, as in substance it only provides a narrow right of use in relation to single cinemas. Accordingly, the payments will be considered to be royalties with effect that royalty withholding tax is payable.

Example 3(b)

53. The facts are also 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. Having regard to the overall contractual terms and its substance, this arrangement has the same effect as Example 3. That is, the payment is in respect of the use of, or right to use the copyright for a short period of time. As a consequence the lump sum payment by AFS in this example is also a royalty under the standard tax treaty and domestic tax definitions and is therefore subject to royalty withholding tax.

Example 3(c)

54. Following the completion of a 6 month Australian theatrical film release copyright assignment period, 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. 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. Considered in total, the factors indicate the partial assignment in this case is comparable to an outright sale of the Australian video/DVD rights. Accordingly, the payment is not a royalty under the standard tax treaty meaning and therefore no royalty withholding tax is payable.

Example 3(d)

55. The facts are also as per Example 3(c) except that FFS is a resident of the US and the lump sum payment is calculated by reference to the anticipated gross revenue to be derived by the exercise of the rights by AFS. The initial lump sum payment is also subject to later variation dependent upon whether the revenue target is not met or is exceeded. Although still an outright sale and not a royalty under the standard treaty definition, in contrast to Example 3(c) the amount paid is calculated by reference to use. However the US tax treaty also contains an additional subparagraph 4(c) (refer paragraph 23 of this Ruling) which expands the definition of royalties to include payments in respect of outright sales where the payment depends upon the productivity, use or further disposition of the copyright. As a result the payment in this case is both a royalty under the US tax treaty (Article 12(4)(c)) and the domestic tax law meaning. It follows that royalty withholding tax is payable.

Date of effect

56. This Ruling applies both before and after its date of issue. However, the Ruling does 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 August 2008

Appendix 1 – Explanation

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

Introduction

57. This Explanation is in two Parts, dealing with the following topics:

Part 1: The legal background to the issues, including most significantly:

- The royalty withholding tax provisions in the ITAA 1936;
- The various relevant definitions of 'royalties';
- The relevant aspects of the law of copyright; and

Part 2: An explanation of the views set out in the Ruling section.

Part 1 – Legal background

Liability for royalty withholding tax

58. A person is liable under subsection 128B(5A) of the ITAA 1936 to pay withholding tax[17] if they derive 'income' that consists of a royalty and the requirements of subsections 128B(2B) or (2C) of the ITAA 1936 are satisfied in relation to that income.
Subsection 128A(1AA) of the ITAA 1936 provides that for the purposes of Division 11A of Part III of the ITAA 1936 and the Act imposing withholding tax the term 'income' includes a royalty. It is therefore critical to establish whether a particular payment made in respect of an assignment of copyright is a 'royalty' for withholding tax purposes.

59. 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 (or certain other persons – see paragraph 61 of this Ruling) and is not an outgoing wholly incurred by the payer in carrying on business in a foreign country at or through a permanent establishment (PE) in that country (subparagraph 128B(2B)(b)(i) of the ITAA 1936); or
- is paid by one or more non-residents and is, or is in part, an outgoing incurred by the non-resident(s) in carrying on business in Australia at or through a PE in Australia (subparagraph 128B(2B)(b)(ii) of the ITAA 1936).

[17] 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).

60. Subsection 128B(2C) of the ITAA 1936 applies to income that consists of a royalty derived by a resident (or certain other persons – see paragraph 61 of this Ruling) in carrying on business in a foreign country at or through a PE in that country that:

- is paid by another resident (or other person mentioned in paragraph 61 of this Ruling) and is not an outgoing wholly incurred by that other person in carrying on business in a foreign country at or through a PE in that country (subparagraph 128B(2C)(b)(i) of the ITAA 1936); or
- is paid by one or more non-residents and is, or is in part, an outgoing incurred by the non-resident(s) in carrying on business in Australia at or through a PE in Australia (subparagraph 128B(2C)(b)(ii) of the ITAA 1936).

61. In so far as subsections 128B(2B) and (2C) of the ITAA 1936 apply to residents, they also apply to a group of persons at least one of whom is a resident; they also apply to the Commonwealth, a State, or an authority of the Commonwealth or of a State: subsection 128B(1A) of the ITAA 1936.

62. 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 the royalty,[18] but it is generally reduced under Australia's tax treaties.[19]

Meaning of 'royalty' – domestic tax law definition

63. For the purposes of section 128B of the ITAA 1936, the term 'royalty' is defined by subsection 6(1) of the ITAA 1936 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) …

This definition is inclusive, in that it extends the meaning of 'royalty' to the amounts mentioned without excluding amounts that would be considered to be royalties within the ordinary meaning as explained by case law of that term.

[18] Paragraph 7(c) of the *Income Tax (Dividends, Interest and Royalties Withholding Tax) Act 1974*.
[19] Mostly this has been to 10%, but in more recent treaties it has been to 5%.

Meaning of 'royalty' – tax treaties definition

64. Australia has comprehensive tax treaties in place with many of its trading partners. The texts of these treaties are set out in Schedules to the Agreements Act. Section 4 of the Agreements Act incorporates into that Act the provisions of the Income Tax Assessments Acts so that the Acts are, in all relevant respects, read as one. If a payment is made by an Australian payer to a resident of a country that has a tax treaty with Australia, the terms of the relevant agreement must be considered. Each of Australia's tax treaties contains an article[20] dealing with royalties in which the meaning of 'royalties' is defined for the purpose of that agreement.

65. In each case, 'royalty' is defined exhaustively in terms similar to the *extended* meaning given by subsection 6(1) of the ITAA 1936. For example, the Finnish Agreement[21] defines 'royalties' as:

> payments or credits, whether periodical or not, and however described or computed, to the extent to which they are made 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; …

As discussed in the Ruling section (paragraphs 21-25 of this Ruling) the definitions in the US and Mexican tax treaties vary somewhat from the standard version.

66. Where the term 'royalty' is defined in a tax treaty that treaty definition prevails over the definition in subsection 6(1) of the ITAA 1936 to the extent of any inconsistency.[22]

67. More particularly, subsection 17A(5) of the Agreements Act provides that if a payment made to a resident of a foreign country with which Australia has a tax treaty is a royalty within the meaning of subsection 6(1) of the ITAA 1936 but is not treated as a royalty under Australia's tax treaty with that country, then section 128B of the ITAA 1936 does not apply. Accordingly no royalty withholding tax applies to such a payment.

68. In a practical sense this means that payments in respect of copyright to residents of countries with which Australia has a tax treaty need to be considered primarily under the relevant treaty definition.

69. In so far as a tax treaty defines 'royalties' in substantially the same terms as the Finnish agreement as set out at paragraph 65 of this Ruling, this Ruling refers to the definition as the 'standard tax treaty definition' of royalties. At present all but the US and Mexican tax treaties do so, and these treaties vary substantively only in the respects discussed in the Ruling section.

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[20] Commonly but not always this appears as Article 12.
[21] See paragraph (3) of Article 12 of the Finnish Agreement as set out in Schedule 25 to the Agreements Act.
[22] Section 4 of the Agreements Act incorporates the provisions of the Income Tax Assessments Acts so that the Acts are read as one. Where there are inconsistencies (other than section 160AO or Part IVA of the ITAA 1936) the terms of the Agreement Act prevail.

70. Some tax treaties include additional matters within the scope of the definition of royalty such as certain payments in respect of films. Each agreement needs to be checked for such references. This Ruling does not give further consideration to this issue.

71. In addition, subsection 17A(4) of the Agreements Act excludes a royalty from withholding tax if the royalty is paid to a resident of a country with which Australia has a tax treaty and another provision[23] of that tax treaty excludes those particular royalties from the royalties article of the tax treaty.

History of definitions

72. The definition of royalties in subsection 6(1) of the ITAA 1936 was inserted into the Act by the *Income Tax Assessment Act (No. 4) 1968*. The first comprehensive definition of 'royalties' in an Australian tax treaty was contained in the Australia-UK Agreement signed on 7 December 1967 and given the force of law in Australia under the International Agreements Act on 8 May 1968. Whilst at that time Australia was not a member of the OECD, this tax treaty was the first treaty entered into by Australia that could be regarded as comparable to the 1963 OECD Draft Double Tax Convention.

73. Since then, the definitions of 'royalties' in Australia's tax treaties have been comparable to that in the OECD model, so far as is relevant to this Ruling.

Previous rulings

74. Taxation Ruling IT 2660 sets out the Commissioner's view on the meaning of royalties in subsection 6(1) of the ITAA 1936 and the various tax treaties in the Schedules to the Agreements Act. The income tax status of payments for assignments of copyright in respect of computer software is covered in Taxation Ruling TR 93/12. Taxation Determination TD 2006/10 deals with one aspect of payments to non-resident authors in respect of copyright. This Ruling deals with the application of royalty withholding tax to assignments of copyright more generally.

75. This Ruling does not revisit the Commissioner's view of the definition of a royalty as set out in IT 2660 in any detail.

PAYG withholding

76. The provisions imposing the relevant obligations to withhold are sections 12-280 and 12-285 of Schedule 1 to the TAA. No withholding, however, is required if withholding tax is not payable on the royalty: section 12-300 of Schedule 1 of the TAA.

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[23] 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.

Copyright

77. 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.

78. 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.

79. Section 31 of the *Copyright Act 1968* (the Copyright Act) 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.

80. Although there are exceptions, generally speaking copyright subsists for a period of 70 years from a reference point as determined under the Copyright Act.[24]

[24] Sections 32 to 34 of the Copyright Act.

Assignment of copyright

81. Under subsection 196(1) of the Copyright Act, copyright may be transferred by assignment, by will and by devolution by operation of law. An assignment of copyright transfers the rights to use the relevant literary, dramatic or musical work such as by way of publication, performance, broadcasting etcetera.

82. Under intellectual property law an assignment is different from the grant of a licence over copyright. To the extent of the assignment, all of the owners' property rights are transferred to the assignee. In particular, this includes the right to take legal action against any third party who infringes the copyright. By contrast, when a copyright holder grants a licence, even an exclusive licence, the licensor retains a right to sue third parties for infringements. (In the case of an exclusive licence, both licensor and licensee may have rights to enforce the copyright against infringing third parties.)[25]

83. Also, a licensee has no right to prevent the copyright owner from continuing to exploit their rights (except so far as the terms of their licence confer this right on them in contract). Whereas, to the extent that copyright is assigned, the assignor is no longer the owner of the copyright and therefore may not continue to exploit it.[26]

84. An assignee may deal with the copyright assigned in any way; for example, by further assigning some or all of it to a third party. A licensee does not have such rights except in so far as the particular licence agreement may be construed as conferring them.[27]

Partial assignments

85. Subsection 196(2) of the Copyright Act 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.

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[25] Ricketson, S (1984) *The Law of Intellectual Property,* Law Book Company Ltd, Sydney at p350

[26] Ricketson, S (1984) *The Law of Intellectual Property,* Law Book Company Ltd, Sydney

[27] Ricketson, S (1984) *The Law of Intellectual Property,* Law Book Company Ltd, Sydney at p358.

86. For example, the copyright in feature films[28] 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 in specific geographical areas.

87. Section 30 of the Copyright Act recognises an assignee as the owner of the particular rights assigned to the assignee. If a partial assignment is made, the transfer of ownership is limited to that part of the copyright assigned with the effect that the assignor remains the owner of the part of the copyright not assigned. Continuing with the above example, a film's owner 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 a residual ownership interest in the copyright and would be free to assign similar rights outside of the areas in question 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. On the expiration of the 6 month period, full ownership will once again rest with the assignor for the remaining period that copyright subsists.

Part 2 – Explanation

Tax treaty situations – standard tax treaty definition

IT 2660: outright sales

88. As a starting point for the analysis the previously published view of the Commissioner, so far as it bears on the issue, is as follows. Taxation Ruling IT 2660, which applies to both the domestic tax law definition and the standard tax treaty definition of royalties,[29] states at paragraph 16:

> The concept of payment 'for the use of, or the right to use' covers all forms of exploitation of a right or property short of outright sale of the right or property. As to copyright, a payment for the right to produce, reproduce or exploit a work or other subject matter in which copyright subsists will be a payment for the use of the copyright, whether or not the right is actually used by the person paying the royalty.

[28] Section 86 of the Copyright Act 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.

[29] IT 2660 paragraph 1.

89. However, the problem presented by cases of assignment is that a payment for an assignment of copyright unlimited in any respect is, as a matter of copyright law, for more than the use or right to use the copyright; it is also for the transfer of all the other rights attaching to ownership of the copyright. This raises the question of partial assignments, under which both the right to use the copyright and some subset of the other rights attaching to ownership are transferred. At what point are the assignor's rights of ownership sufficiently alienated that the transaction can be better characterised for tax purposes as an 'outright sale' rather than the conferral of a right to use?

90. One view is that only if absolutely all of the assignor's rights of ownership in the entire copyright are transferred will the arrangement be viewed as an outright sale. At the other end of the scale, another view is that it is sufficient for any of those rights, however restricted, (beyond mere rights to use) to be transferred for the arrangement to be treated as an outright sale. The Commissioner's view is that *substantially* all of the rights must be transferred but that it is not necessary that every legal right be transferred, if in taking an overall view of the transaction the limitations on the scope of the assignment are not so significant in practical terms to detract from the nature of the assignment as an outright sale.

91. The correct view cannot be inferred simply by studying the wording of the standard tax treaty definition, especially as the concept of a partial assignment does not seem to have been expressly contemplated in the drafting of the definition. It is necessary to analyse the problem further in the light of such authorities and extrinsic materials as are available.

Case law

92. To date there is no case law in Australia that directly assists with the question of the status of payments for the assignment of copyright under the royalties article of Australia's tax treaties (or the equivalent provision in subsection 6(1) of the ITAA 1936).

93. However there is relevant case law from comparable overseas countries. A series of Canadian cases dealt with broadly similar issues some time ago.[30] Whilst the relevant definition of 'royalties' in each case was not exactly the same as in the current context, the Commissioner takes these cases as general support for the principle that the proceeds of outright sales are not taxable as royalties, whereas limitations on the scope of an assignment, especially as regards time, are strongly indicative that the relevant payment is a royalty, even if the payment is a lump sum or is a capital outlay.

94. A more detailed account of these Canadian decisions appears in paragraphs 128 to 132 of Appendix 2 of this Ruling.

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[30] See *Minister of National Revenue v. Paris Canada Films Limited* [1962] DTC 1338; *Vauban Productions v. HMQ* [1975] CTC 511, confirmed on appeal at [1979] CTC 262; *Peliculas Sari SA v. The Minister of National Revenue* [1980] DTC 1766.

OECD Model Commentary

95. In interpreting an article of a tax treaty, and particularly one such as this whose application in a particular domestic law context is not self-evident, it is appropriate to have regard to the official OECD Commentary (the Commentary) on the Model Tax Convention, including the changes that have occurred to the Commentary over time.[31]

96. The current version of the Commentary[32] on the royalties article opens with this statement:

> In principle, royalties in respect of licences to use patents and similar property and similar payments are income to the recipient from a letting.

97. The Commissioner has considered the Commentary on the definition of royalties in TR 98/21 in relation to certain cross border leasing arrangements and in TD 2007/31 concerning hire purchase arrangements.[33] In both rulings the Commissioner considered that the context drew a consistent distinction between sale and hire that was not solely dependent for its determination upon the legal form of a transaction, but required regard to be given to the overall substance of the arrangement.[34] Turning to the more specific question of copyright, it is not completely clear which payments for a partial assignment of copyright would be 'similar' to a royalty in respect of a licence given the breadth within which assignments can be limited. However, having regard to the statement of 'principle' above, and the Commissioner's approach to interpretation of the royalty definition as explained in relation to other arrangements, it is considered that the answer is not found in mere legal form and that there is a boundary to be found between a full assignment of all rights and a mere licence within which a payment ceases to be 'similar' to a licence fee.

98. The next relevant statement is the opening sentence of paragraph 8.2 of the Commentary:

> Where a payment is in consideration for the transfer of the full ownership of an element of property referred to in the definition, the payment is not in consideration 'for the use of, or the right to use' that property and cannot therefore represent a royalty.

This statement accords with the view expressed in paragraph 14 of this Ruling.

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[31] See Taxation Ruling TR 2001/13 at paragraphs 101-108 and TR 98/21 at paragraph 28.

[32] It is relevant to note that the OECD Council has recently approved changes to the 2005 Commentary. The 18 July 2008 update will be treated as the 'current version' hereinafter.

[33] This had particular reference to paragraph 9 of the 1977 Commentary which was deleted following the 1992 OECD decision to remove equipment rentals from the Royalties article. Note however that the majority of Australia's tax treaties contain the relevant terminology in the definition.

[34] See TD 2007/31 at paragraphs 12-15 and TR 98/21 at paragraphs 25-26.

99. Paragraph 8.2 of the Commentary also relevantly states:

> As noted in paragraphs 15 and 16 below as regards software, difficulties can arise in the case of a transfer of rights that could be considered to form part of an element of property referred to in the definition where these rights are transferred in a way that is presented as an alienation. For example, this could involve the exclusive granting of all rights to an intellectual property for a limited period or all rights to the property in a limited geographical area in a transaction structured as a sale. Each case will depend on its particular facts and will need to be examined in light of the national intellectual property law applicable to the relevant type of property and the national law rules as regards what constitutes an alienation but in general, if the payment is in consideration for the alienation of rights that constitute distinct and specific property (which is more likely in the case of geographically-limited than time-limited rights), such payments are likely to be commercial income within Article 7 or a capital gains matter within Article 13 rather than royalties within Article 12

These statements point to the likelihood of a distinction arising in relation to characterisation between transfers of rights (constituting distinct and specific property) which are limited by geography as compared with transfers of such rights limited by time. Again the necessity to consider each case on its particular facts suggests that an answer cannot be found by reference to mere legal form alone.

100. The Commentary has been amended to insert and modify[35] some remarks about copyright over computer software specifically. In the course of this passage, paragraph 13.1 of the Commentary now states as follows:

> Payments made for the acquisition of partial rights in the copyright (without the transfer fully alienating the copyright rights) will represent a royalty where the consideration is for granting of rights to use the program in a manner that would, without such a license, constitute an infringement of copyright.

101. This seems to assume a distinction between licences and outright sales (full alienation) without specifically addressing the in-between case of partial assignments.

102. However, paragraphs 15 and 16 of the Commentary, in relation to software, continue as follows:

> 15. Where consideration is paid for the transfer of the full ownership of the rights in the copyright, the payment cannot represent a royalty and the provisions of the Article are not applicable. Difficulties can arise where there is a transfer of rights involving:
>
> - Exclusive right of use of the copyright during a specific period or in a limited geographical area;
> - Additional consideration related to usage;
> - Consideration in the form of a substantial lump sum payment.

[35] Paragraphs 12-17 added to the Commentary in 1992 and modified in 2000, 2003, and 2008.

> 16. Each case will depend on its particular facts but in general if the payment is in consideration for the transfer of rights that constitute a distinct and specific property (which is more likely in the case of geographically-limited than time-limited rights), such payments are likely to be business profits within Article 7 or a capital gain within Article 13 rather than royalties within Article 12. That follows from the fact that where ownership of rights has been alienated in full the consideration cannot be for the use of rights….

103. Paragraph 8.2 (and the related statements of specific application to software in paragraphs 15 and 16) of the Commentary addresses the problem with which this Ruling is concerned. The view expressed emphasises the nature and extent of limitations on rights transferred. In terms of any 'weighting' of relevant considerations the view appears to be that payments for rights that are subject to significant limits based on time are likely to be royalties. Furthermore, the addition of the words 'of the copyright' to paragraph 15 in conjunction with the concept of 'distinct and specific property' in paragraph 16 place attention upon the limitations of class of rights assigned without drawing any precise conclusions as to the borders of the concept. Broadly speaking, where there is an *extensive* but partial alienation of rights (less likely if time is limited), the consideration is not a royalty for treaty purposes. By implication, where the element of alienation of ownership in the particular transaction is not significant in the context of the 'entire' copyright, the payments are royalties.

104. The Commissioner considers that the view in the Commentary is essentially consistent with the view taken in this Ruling.

Academic commentators

105. Vogel[36] although not dealing with the question in great depth, suggests that the decisive difference between 'letting an asset for use' and 'transferring its substance by alienation' in this connection 'is the degree of change in the attribution of the asset from licensor to licensee'.[37] It would follow that merely transferring ownership to an assignee to *some* extent does not automatically prevent the royalties article from applying; it is a question of degree.

[36] K. Vogel and others (1997) *Klaus Vogel on Double Taxation Conventions* 3rd ed. (in translation), Kluwer Law International Ltd, Munich

[37] K. Vogel and others (1997) *Klaus Vogel on Double Taxation Conventions* 3rd ed. (in translation), Kluwer Law International Ltd, Munich at 787.

106. On the particular subject of time limits, *Vogel's Commentary* opines that these are *characteristic features* of licences, but that a sale *may* involve a time limit, if it is coupled with an obligation to re-transfer at a later time[38] (which is more or less the effect of an assignment limited by time under Australian law). In other words, the presence of a time limit on an assignment points towards a finding of a royalty, but is not the decisive factor in every case. Vogel also notes that 'a letting for an unlimited term instead of a sale may be a 'licence', because some (not inessential) partial rights have remained in the hands of the licensor'.[39]

107. Baker[40] also briefly discusses the wider issue in relation to royalties more generally by reference to a discussion of the Canadian case of *Vauban Productions v. R*[41]. Without concluding a view on the wider issue Baker explains the case as a 'lease' rather than an outright sale as the company did not acquire all the rights over the films but only certain rights and had to return the films at the end of the period of the agreement.[42]

108. These views are consistent with this Ruling.

Analysis

109. On the strength of the above material, the Commissioner considers that the standard tax treaty definition denotes a class of payment that is wider than mere payments for a licence to use copyright as understood under the domestic Australian law of copyright. The language in the Model Convention of 'the use of, or the right to use' is general and needs to be interpreted liberally enough to cater for variations in local laws, where in substance the payment in question is more akin to a payment for use than a payment for the transfer of ownership.

110. Faced then in the context of the royalty definition with the task of determining the substance of an arrangement presented by any particular assignment, one looks for suitable indicia by which to measure this. The three main modes of restriction of alienation stipulated by the Copyright Act, as set out in paragraph 85 of this Ruling, suggest themselves. As a general principle there is no reason to think any of them decisive by itself however it is also not suggested that each factor is necessarily of equal weight.

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[38] K. Vogel and others (1997) *Klaus Vogel on Double Taxation Conventions* 3rd ed. (in translation), Kluwer Law International Ltd, Munich at p 788.
[39] K. Vogel and others (1997) *Klaus Vogel on Double Taxation Conventions* 3rd ed. (in translation), Kluwer Law International Ltd, Munich at 788 citing the earlier mentioned Canadian case of *Vauban Productions v. R* [1979] CTC 262.
[40] P Baker *Double Tax Conventions,* Loose leaf, Sweet and Maxwell, London 2007
[41] Vauban Productions v. R [1979] CTC 262
[42] P Baker *Double Tax Conventions,* Loose leaf, Sweet and Maxwell, London 2007 at 12-3.

111. Additionally, it is difficult to see the criteria by which the payment is calculated as irrelevant to the decision. The question is, to what extent has A alienated their ownership of property to B? Alienating some or all of the risk that the property might not make much money seems an obvious aspect of this. This is why the Commissioner reads the expression 'whether periodical or not, and however described or computed' as doing two things. First, as ruling out any argument that just because the payment is computed not by reference to actual use, the payment cannot be a royalty. Secondly, as not ruling out recourse to the mode and timing of calculation as a relevant factor.

112. On the subject of time limits, a particular analogy may be drawn with the distinction in general property law between a sale and a lease. In general property law a sale conveys the idea of a transfer of all the rights in an item of property in perpetuity. A lease is limited by time and the lessor retains a reversionary interest in the property with respect to the period after the lease expires. Lease payments may more naturally be thought to be not for the (temporary) ownership of an asset but rather paid in return for the possession and use of the asset for a specified period. This analogy suggests that payments for the temporary use of copyright are for the use of, or right to use, the copyright and would therefore fall within the definition of 'royalties'.[43]

113. The analogy with leasehold interests is not quite perfect however because, as discussed above, an assignment of copyright, even when limited by time, still confers *all* the rights of ownership on the assignee for that period of time.[44] For so long as the assignment endures this would put the assignee in a more favourable legal position, both as against the assignor and as against third parties, than that of a lessee of land for example. Nevertheless, if an assignment resembles a lease more than a sale (a 'letting', per the OECD Commentary), this is strongly suggestive of a royalty. This view is consistent with the thrust of the Canadian cases cited earlier.

Timing of payments and method of calculation

114. Unlike the position under the ordinary meaning of 'royalty' as explained by case law, it is not necessary under the standard tax treaty definition for a 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, is a royalty. The form of the payment and the way in which it is computed is not conclusive in determining whether the payment is a royalty under the treaty definition and the extended meaning given by subsection 6(1) of the ITAA 1936.

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[43] For example, see Taxation Ruling TR 2007/11 which discusses royalty withholding tax in respect of leasing arrangements involving substantial equipment.

[44] The Copyright Act does not make provision for copyright to be leased. It may be assigned or licensed (section 196). The closest equivalents of a lease would be a partial assignment limited by time or an exclusive licence granted for a specific period of time.

115. In *Case U33,*[45] 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.

116. However, the Commissioner does not take this as establishing that the mode of payment is irrelevant in all cases concerning the extended definition (which is relevantly, other than being inclusive, similar to the standard tax treaty definition). In particular, in the case of partial assignments, there can be (as discussed above) questions in marginal cases as to whether the payment is 'for the use of, or the right to use' a copyright having regard to the other features of the transaction. If a payment plainly meets that description then the mode of the computation and the timing of the payments are irrelevant. But in marginal cases where the other factors are finely balanced, where the payments are periodical, and/or the basis on which they are calculated is connected to an estimate of use; this would positively point towards the payments being royalties.

The US and Mexican tax treaties

117. As mentioned in the Ruling section, the Commissioner interprets the use of the phrase 'of any kind' instead of 'whether periodical or not, and however described or computed' as giving rise to no material difference in the scope of the definition. In context, there seems to be nothing to indicate that any different effect was intended by these words. They are just another way of addressing the same general issue.

[45] 87 ATC 250; (1987) 18 ATR 3194.

118. Furthermore as explained at paragraph 24 of this Ruling, under subparagraph (4)(c) of the US tax treaty any payments made to a beneficially entitled US resident as consideration for an assignment of copyright will be a royalty where the amounts are contingent on the productivity, use or further disposition of the copyright. The US Technical Explanation to this tax treaty[46] states:

> Subparagraph (c) of paragraph 4 provides that, to the extent to which income from the disposition of any property or right described in this paragraph is contingent on the productivity use or further disposition of such property or right, it is a royalty.

119. In relation to paragraph (4) of Article 12 of the Mexican tax treaty the Explanatory Memorandum[47] at paragraph 2.133 states:

> The tax treaty provides that the term ***royalties*** includes income derived from the sale, exchange or other disposition of any property or right described in this Article to the extent to which the amount realised on such sale, exchange or other disposition are contingent on the productivity, use or further disposition of such property or right. The purpose of this paragraph is to prevent the conversion of royalties into long-term payments for the 'sale' of the underlying property. This provision ensures that the payment continues to fall within the scope of this Article.

Domestic tax law situations

Extended definition

120. Consistently with the approach taken in TR 98/21 in a related context,[48] the definition in paragraph (a) of the subsection 6(1) of the ITAA 1936 definition should be interpreted in line with the view taken of the tax treaty definitions which inspired it. All of the above discussion about the standard tax treaty definition applies equally to paragraph (a) of the subsection 6(1) of the definition.

121. See further paragraphs 77 and 78 of Taxation Ruling TR 2001/13 for the Commissioner's general approach in these situations.

Ordinary meaning as explained by case law

122. That leaves the question of the ordinary meaning of 'royalties', as the courts have developed this concept in tax cases. The key characteristics of a royalty under the ordinary meaning as explained by case law are set out in IT 2660.

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[46] United States Treasury Department Technical Explanation Of The Convention Between The Government Of The United States Of America And The Government Of Australia For The Avoidance Of Double Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income 0f May 24 1983.

[47] Explanatory memorandum accompanying the International Tax Agreements Amendment Bill 2003

[48] See paragraph 24 of TR 98/21.

123. The Australian cases on the ordinary meaning of royalty, as cited in IT 2660, do not address the question of whether the concept is capable of extending to payments for an assignment, if the other characteristics of a royalty are present. Most of the cases refer to 'licences' without addressing the point specifically.

124. The Commissioner's view is that, in the case where an assignment is paid for on the basis of the actual use or exploitation of the rights transferred, the flow of payments resulting would sufficiently resemble the kinds of payment that have been found to be royalties in those cases. The essential determinant appears to be the basis on which the payments are calculated, rather than the exact nature of the legal rights transferred. If the payments are calculated by reference to use, it can be deduced that they are in the nature of payment for the right to use rather than by way of purchase of the other rights attaching to ownership of the copyright.

125. Royalties as ordinarily understood are usually periodic payments, payable as and when the right acquired is exercised. However, a lump sum payment is a royalty if it is a pre-estimate or an after the event recognition of the amount of use made of the right acquired.

126. Any amounts paid or credited as consideration for the assignment of copyright that fall within the ordinary meaning of 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 subsections 128B(2B) or 128B(2C) of the ITAA 1936 are satisfied.

Payments that are partly royalties

127. The words 'to the extent to which' in both the standard tax treaty definition and the domestic tax law definition of royalty requires the dissection or apportionment of a consideration given partly as a royalty and partly as something else. Only the royalty component of the consideration is liable to royalty withholding tax. The OECD Commentary provides an example at paragraph 18 of a 'mixed contract' under which a musical performer receives a fee for the performance itself, and on the basis of his copyright in its recording, a royalty on the sale or playing of the recording.[49] A dissection or apportionment of such arrangements would need to be determined on a reasonable basis having particular regard to the facts and circumstances surrounding the case in question. Note the practical approach adopted in paragraph 11.6 of the OECD Commentary in relation to 'parts' of a mixed contract that are of an 'ancillary and largely unimportant character' wherein apportionment is not required.

[49] IT 2660 also contains an example at paragraph 13 concerning an agreement for the outright sale of manufacturing machinery and also for the right to manufacture and sell the product under a brand name.

Appendix 2 – Discussion of Canadian cases

128. The following is a more detailed account of the Canadian decisions cited at paragraph 93 of Appendix 1 of this Ruling.

129. In the first case, the Exchequer Court of Canada in *Minister of National Revenue v. Paris Canada Films Limited*[50] (*Paris Canada Films*) distinguished between two types of film distribution agreements. A Canadian film distributor made payments for a number of films, some in respect of rights assigned irrevocably and others where the film rights were only assigned for a period of five years. The film rights irrevocably ceded were assigned in perpetuity, for the exploitation of all the rights and the transaction was considered to be the equivalent of a disposal or sale with effect therefore that the payments were not considered to be royalties. In contrast the assignments for limited terms of five years were not considered to be sales and hence the payments were royalties being 'income from the lease of motion picture films'. This case highlights that the important difference in characterising the transactions was the time limitation. That is, a transfer limited by time is not a sale.

130. This decision was subsequently cited in *Vauban Productions v. HMQ*.[51] In this case a French film distributor obtained film rights for a limited period which it then transferred under contract to the Canadian Broadcasting Corporation for the same limited period. The court determined at paragraph 13 that:

> The sole question to be determined therefore is whether the contract between the Plaintiff [the Distributor] and the CBC was for the leasing of films or whether it was one for the outright sale of rights.

131. The court identified 3 clauses of the contract that it considered would only apply to the leasing of a right. First, ownership of the property was to remain with the Distributor. Secondly, a clause granted editing rights which was inconsistent with the concept that the transferor intended to divest himself of all rights at the time of transfer. Lastly, the films had to be returned to the Distributor which indicated a residuary possessory right. The court reasoned as follows at paragraphs 23 to 25:

> The three above-quoted clauses from the contract are completely consistent with the concept of a leasing of a right or the temporary assignment of part of the right to the plaintiff and are inconsistent with an absolute sale. The fact that the consideration was paid in a lump sum and not by instalments does not alter the nature of the transaction.

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[50] [1962] CTC 538; [1962] DTC 1338

[51] [1975] CTC 511. Decision subsequently confirmed on appeal by the Federal Court of Appeal in Vauban Production v. R [1979] CTC 262.

> Where, in circumstances such as the present case, there has not been an absolute transfer of the rights of the distributor of films to another party as a user, then, for the purposes of Article 13, paragraphs III and IV of the Convention, the transaction is to be considered a leasing of film rights. A decision which has some bearing on the subject is one by the Exchequer Court in the case of *MNR v. Paris Canada Films Limited* [1962] CTC 538, 62 DTC 1338. In two of the situations with which the Court was concerned in that case, exclusive rights were transferred from one distributor, who apparently had all the rights to the film, to another for a limited number of years, in consideration of a bulk sum payment. Dumoulin, J held, in the circumstances, that that particular contract constituted a leasing. At page 544 [1342] of the report he is quoted as saying:
>
> > Notwithstanding the mention, in exhibits 9 and 10, of the term 'cession', currently associated with notions of sale, the purport of the transaction, a grant of cinematographic reproduction rights for a five-year period at global prices of, respectively, $3,500 and $5,000, undoubtedly fall in the classification of 'income from the lease of motion picture films'.
>
> Although it does not appear to be categorically stated in the case itself, it appears that the decision as to exhibits 9 and 10, to which the learned judge was referring in the above quotation, turned on the fact that there existed a reversionary interest in the original distributor.

132. The *Paris Canada Films* decision was subsequently further analysed by the Tax Review Board in *Peliculas Sari SA v. The Minister of National Revenue*[52]. The Tax Review Board found that the substance of the agreement at issue was that the vendor sold all its rights, title and interest in the film to the purchaser. That is, the payments were for the ownership of the film and not in respect of its use. At paragraph 5.3.9:

> 5.3.9 Most of the cases referred to by the parties conclude that a payment for an outright sale of a film is not taxable, and a payment for a lease or royalties of a film is taxable. However, sometimes the decision was based, not on 212(5), but on 212(1)(d) which taxes payment on 'rent, royalties, or a smaller payment' -- (*La Société Nouvelle de Cinématographie Inc. v. M.N.R.*), or on the convention between Canada and the country of the non-resident taxpayer -- (Vauban Productions v. H.M.Q.).
>
> 5.3.10 However, in the case of *M.N.R. v. Paris Canada Films Ltd.*, Mr. Justice Dumoulin wrote the following:
>
> > The sole question at issue is whether or not Paris Canada Films Ltd. obtained from nonresidents 'a right in or to the use of motion picture films', to be produced in Canada, even though such a right might be derived from an outright 'purchase'.
>
> This sentence, according to the respondent, is the confirmation that an outright purchase is taxable. This is the respondent's contention.

---

[52] [1980] DTC 1766

At first glance the sentence is not clear. However, first let us notice that the word 'purchase' in the sentence is between quotes. It was the contention of the taxpayer company that it was a purchase. The words 'purchase of the films' were used in the agreements. After studying the agreements, however, for many reasons he arrived in sum at the conclusion that the substance of the agreements was not of a purchase, but a lease. There was a five year limit of explanation in those agreements. At page 1341, Mr. Justice Dumoulin says:

> It seems a waste of time to underscore that each of those five contracts possessed all the elements attaching to a 'right to the use of motion picture films … that are to be reproduced in Canada', and none of the essential components of a 'purchase'.

Mr. Justice Dumoulin would not use the words 'none of the essential components of a purchase' if, in the underlined sentence previously cited, his intention was to affirm that an outright purchase is taxed.

In other agreements in the same judicial case there was no time limit in the explanation. At page 1342, Mr. Justice Dumoulin says:

> The only commercially profitable use to which motion picture films can be put consists in their reproduction on the theatrical screens of the land. Then, an assignment in perpetuity of all explanation rights to those 59 films, listed in exhibit 11, by a non-resident company whose regular business it is to transact such deals, seems equivalent to a disposal, or sale, of so many 'inventory or stock in trade goods', productive of corresponding 'industrial and commercial profits'.

Appendix 3 – Alternative views

This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the binding public ruling.

133. An alternative view is that payments for all assignments of copyright, no matter how restricted the assignment is by time, rights granted, geographic location, or any combination of these factors are not royalties. The view is that such assignments are a sale of an intangible asset and therefore cannot under any circumstances be a royalty for tax purposes which connotes the granting of a mere right to use.

134. This alternative view is not accepted by the Commissioner for the reasons given in Part 2 of the Explanation section.

Appendix 4 – Detailed contents list

135. The following is a detailed contents list for this Ruling:

	Paragraph
What this Ruling is about	**1**
Class of entities/scheme	4
Definitions	6
crediting of amounts	6
'tax treaty'	7
'standard tax treaty definition'	8
'domestic tax law definition'	10
Ruling	**11**
Tax treaty situations-standard tax treaty definition	11
The US and Mexican tax treaties	21
Domestic tax law situations	26
Payments that are partly royalties	31
PAYG withholding	32
Examples	**35**
Example 1	36
Example 1(a)	40
Example 2	42
Example 2(a)	44
Example 2(b)	46
Example 3	48
Example 3(a)	52
Example 3(b)	53
Example 3(c)	54
Example 3(d)	55
Date of effect	**56**
Appendix 1 – Explanation	**57**
Introduction	57
Part 1 – Legal background	58
Liability for royalty withholding tax	58
Meaning of 'royalty' – domestic tax law definition	63
Meaning of 'royalty' – tax treaties definition	64
History of Definitions	72

Previous rulings 74
PAYG withholding 76
Copyright 77
Assignment of copyright 81
Partial assignments 85
Part 2 – Explanation 88
Tax treaty situations – standard tax treaty definition 88
IT 2660: outright sales 88
Case law 92
OECD Model Commentary 95
Academic commentators 105
Analysis 109
Timing of payments and method of calculation 114
The US and Mexican tax treaties 117
Domestic tax law situations 120
Extended definition 120
Ordinary meaning as explained by case law 122
Payments that are partly royalties 127
Appendix 2 – Discussion of Canadian Cases 128
Appendix 3 – Alternative Views 133
Appendix 4 – Detailed contents list 135

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Previously issued as TR 2007/D5

Related Rulings/Determinations:

IT 2660; TR 93/12; TR 98/21;
TR 2001/13; TR 2003/2;
TR 2006/10; TR 2007/11;
TD 2006/10; TD 2007/31

Subject references:

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

Legislative references:

- ITAA 1936
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- Minister of National Revenue v. Paris Canada Films Limited [1962] CTC 538; [1962] DTC 1338
- Pacific Film Laboratories Pty Ltd v. FCT (1970) 121 CLR 154; 70 ATC 4104; (1970) 1 ATR 771
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