Broadening the tax base

Sales Tax on licenced software

Authors of software have long preferred to license the use of their programs, rather than sell them outright. Now, the Federal Government has imposed a sales tax of 20% on such licences.

The effect of this on software companies was considered at an interesting meeting of the NSW Society for Computers and the Law.

The Explanatory Memorandum circulated with the Budget contains an excellent definition:

"Sales tax is a single stage tax levied on, or in relation to, goods. It is designed to fall at the wholesale level but is payable by manufacturers and importers, as well as by wholesalers, the tax in each case being based on a sale value equivalent to the wholesale value of the goods.

The overall intention is that goods produced in, or imported into Australia for use or consumption here will bear the tax unless they are specifically exempt.

The levy is not limited to sales. Where goods have not already borne tax it could, for example, fall on leases of those goods or on the application of those goods to a taxpayer's own use.

Manufacturers and wholesalers are required to register. When registered, they are issued with a certificate of registration and, by quoting the certificate number when purchasing goods or entering imported goods for home consumption, they can acquire the goods free of tax.

The system of quoting certificates is designed to defer payment of the tax until the last wholesale sale."

Sales Tax: The 1984 Decision

Before the latest changes made in the Federal Budget, where computer programs were copied onto discs or tapes and supplied under licence, sales tax was payable only on the value of the blank discs or tapes and a minimal dubbing charge.

Mark Redford, an expert on sales tax with Coopers & Lybrand, pointed out this approach had been sanctioned by the Commissioner of Taxation in 1984 when he set down an interim "sales value" (i.e., the value on which sales tax at 20% is payable) of "the value of the software carrying medium plus the cost of dubbing the software on to the medium". The "medium" refers to discs or tapes on which the program is supplied.

This sale value applied only where there was no wholesale sale of the program. Thus, it applied where software was sold by retail or supplied under licence.

Software is now taxed on a more punitive basis than "goods"

Licensing agreements were already in use in the computer industry, because they enabled programmers to retain control over their programs. After the 1984 decision, such agreements became more popular.

The Effect of the Amendments

"Computer Program" is now defined in the same way as in the Copyright Act 1968, where it includes an expression of a set of computer instructions in any language, code or notation.

The definition of "manufacture" has been expanded to cover *"the copying or reproduction of a computer program, whether with or without related information and whether in the same material form or in a different material form, or the conversion of a computer program to another language, code or notation, so as to embody the computer program in goods."*

The phrase "material form" includes any form, whether visible or not, or storage from which the computer program can be reproduced. Thus, manufacture will include any copying or reproduction of a program, or conversion of a program into machine readable language.

A computer program is "embodied in goods" under the amendments if it is stored on tapes, discs, Read Only Memories (ROMs), Erasable Programmable Read Only Memory (EPROMs), magnetic bubble memory or any other method of storage.

Even programs contained in household appliances like washing machines and dishwashers may attract the new sales tax. However, it probably does not apply to information sent from one computer to another by modem.

The sales tax cannot be avoided by the user providing his or her own discs to the supplier to copy the program. In this situation, the user will be the deemed manufacturer for sales tax purposes if he or she requires the goods for sale.

Similarly, sales tax is attracted by supply of a program by one person to another for copyright, reproduction or conversion to another language for embodiment in goods.

The supplier of the program will be the deemed manufacturer, if he or she requires the copies for sale.

If the supplier gives the copies or goods to someone, then that will be deemed to be a sale of the goods.

In the opinion of Philip Argy, Past President of the NSW Society for Computers and The Law, this applies only to gifts where property in the goods passes from the supplier. It also applies to supply under licence.

The sale value, on which sales tax is calculated, includes the full cost of all valuable consideration ("the licence fee") given in connection with the supply or right to use the program.

Thus, services normally supplied with a licence to use a program - development, training, installation and the like - are included in the sale value.

Even manuals are not exempt from the sales tax, although in Mark Redford's view, they should be because they are "printed media".

Sales tax is thus payable on the program package of disc and manual. Further copies of the manual are exempt. This calculation of the sale value applies to both wholesale (sales to dealers) and retail (direct to users).

Mark Redford notes that, in other industries, a manufacturer who sells by wholesale and retail is taxed on a sales value for all sales based on the wholesale price.

Software manufacturers are required to pay tax on the retail price. This certainly seems to be an unfair anomaly in the legislation.

On the other hand, software retailers will not be required to register or pay tax on software distributed by them. They will pay sales tax to suppliers or to importers of software.

If users copy programs onto their own equipment for back-up purposes or develop software for in-house use, they will not have to pay sales tax. This may have the side-effect of encouraging software pirating at the user end!