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SUBJECT Software License Agreement
SECTION ITA 212(1)(d)

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PRINCIPAL ISSUES: Whether withholding tax is applicable to payments made under a computer software licensing agreement?
POSITION: Question of fact whether the payments are exempt from withholding tax by virtue of subparagraph 212(1)(d)(vi) of the Act.
REASONS: Consistent with the CRA's published position regarding payments made for the right to use, reproduce or distribute computer software programs.

XXXXXXXXXX

2012-044109
K. Podor

November 23, 2012

Dear XXXXXXXXXX:

Re: Computer Software License Agreements

We are writing in response to your email, dated March 23, 2012, concerning the taxation of amounts paid by a Canadian resident corporation to a non-resident corporation under a computer software licensing agreement for the purposes of the Income Tax Act (the "Act").

You asked our views regarding whether the payments are exempt from Canadian withholding requirements under the Act.

A corporation resident in XXXXXXXXXX designs and develops computer software programs. A Canadian company is a manufacturer and distributor of equipment in Canada. The XXXXXXXXXX company licensed custom computer software to the Canadian company under an exclusive license agreement. The Canadian company acquired the right to reproduce and distribute the software in the manufacture and sale of devices in Canada. The license agreement also covers the provision of technical services. All technical services are rendered outside of Canada. The license agreement sets out the fees on a cost plus basis (salaries and benefits plus a markup). The XXXXXXXXXX company retains ownership of the computer software copyright throughout the term of the license agreement.

Our Comments

Whether payments for a computer software program should be characterized as royalties is a question of fact that can only be determined by reviewing the licensing agreement associated with the right to use the particular computer software program. Although we cannot provide any comments with respect to the specific licensing agreement, we offer general comments.

You are asking whether payments under a computer software license agreement are exempt from withholding tax by virtue of subparagraph 212(1)(d)(vi) of the Act.

Paragraph 212(1)(d) imposes a 25% withholding tax on income in the nature of rents or royalties received by non-resident persons from a person resident in Canada for the use, or a right to the use, in Canada of property belonging to the non-resident. Specifically, paragraph 212(1)(d) of the Act provides:

"212(1)(d) rents, royalties, etc. - rent, royalty or similar payment, including, but not so as to restrict the generality of the foregoing, any payment
(i) for the use of or for the right to use in Canada any property, invention, trade-name, patent, trade-mark, design or model, plan, secret formula, process or other thing whatever,

...

but not including

(vi) a royalty or similar payment on or in respect of a copyright in respect of the production or reproduction of any literary, dramatic, musical or artistic work,..."

The term ‘custom computer software’ generally describes computer software the use of which is subject to a specific computer software license agreement. As a condition to the end-user acquiring the right to use the

computer software, the end-user is required to enter into a computer software license agreement with respect to the use of the software. Such agreement will usually set out the amount of and the description of the fees to be paid under the particular computer license and the agreement will usually be signed by both parties to acknowledge acceptance of the term." We consider payments for "custom computer software" to be a payment of a royalty for Canadian tax purposes. Therefore, the fees paid pursuant to the computer software license agreement, for the right to use, reproduce and distribute computer software in the manufacture of devices in Canada, fall within the meaning of a "royalty" for Canadian tax purposes and are subject to tax under paragraph 212(1)(d) of the Act. However, subparagraph 212(1)(d)(vi) excludes, among other things, a royalty or similar payment that is on or is in respect of a copyright of the production or reproduction of a literary work. Subparagraph 212(1)(d)(vi) generally applies to software as the Copyright Act defines "literary work" to include a computer program. Please refer to our published comments in paragraph 3 of Interpretation Bulletin - 303SR (Special Release), "Know-How and Similar Payments to Non-Residents".

You are also asking about technical services that are also provided under the computer software license agreement. We do not have sufficient information regarding the nature of these services. It is our understanding that the technical services are rendered within XXXXXXXXXX. Section 105(1) of the Income Tax Regulations (the "Regulations") provides that every person paying to a non-resident a fee, commission, or other amount in respect of services rendered in Canada of any nature whatever must deduct or withhold 15 per cent of such payment. As you indicate that the technical services performed by the XXXXXXXXXX company for the Canadian company are not rendered within Canada, the payment for these services would not be subject to Canadian withholding tax under section 105 of the Regulations.

We trust these comments are helpful.

Yours truly,

G. Moore
For Director
International Division
Income Tax Rulings Directorate
Legislative Policy and Regulatory Affairs Branch