IT 2669 - Income tax: collection of tax on royalties and natural resource payments payable to non-residents

TAXATION RULING IT 2669

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I 1013065	**ROYALTIES** **NATURAL RESOURCE PAYMENTS** **- ACCUMULATION** **- DEEMED PAYMENT** **- DERIVATION BY NON-RESIDENT**	**6(1), 6C, 25(1), 26(f), 221YHZA(2), 221YHZB, 221YHZC, 221YHZD**

OTHER RULINGS ON THIS TOPIC: IT 2660

TITLE: INCOME TAX: COLLECTION OF TAX ON ROYALTIES AND NATURAL RESOURCE PAYMENTS PAYABLE TO NON-RESIDENTS

NOTE: . Income Tax Rulings do not have the force of law.

. Each decision made by the Australian Taxation Office is made on the merits of each individual case having regard to any relevant Ruling.

PREAMBLE

The purpose of this Ruling is to state the Commissioner's views on:

(a) the provisions of the Income Tax Assessment Act 1936 (the Act) concerning the obligations of a person making payments of Australian-sourced royalties to a non-resident (including obligations to deduct tax from the payments and to remit the tax to the Commissioner); and

(b) when the royalty payments are derived by the non-resident for Australian income tax purposes.

2. The provisions of Division 3B of Part VI of the Act impose an obligation on a person who is liable to make Australian-sourced royalty payments (including royalties deemed to have an Australian source under section 6C) to a non-resident to notify the Commissioner of the amount of the royalties before payment of them (subsection 221YHZB(1)), to deduct tax from each payment (section 221YHZC) and to remit the tax deducted to the Commissioner (section 221YHZD). The collection provisions of Division 3B also apply to natural resource payments and the views expressed in this Ruling will apply equally to such payments.

3. It has come to the notice of this Office that some royalty payers are not notifying the Commissioner of the amount of the royalties until such time as the royalties are about to be sent overseas, in some cases as much as two years after they have become due and payable. It appears that the payers of the royalties are taking the view that there is no payment until that time. A similar problem has been encountered with the deduction of tax under section 221YHZC and remittance under section 221YHZD of the tax deducted.

4. This Ruling looks at when a "payment" may be said to have occurred for purposes of Division 3B, and seeks to clarify when the obligations under that Division arise in relation to royalties which are not paid over to the non-resident, but are retained in Australia by the payer of the royalties. The Commissioner's views on the time of derivation of royalties and the tax obligations of the non-resident recipient are also set out.

SUMMARY

5. The time of payment of a royalty is critical to the operation of the provisions of Division 3B. A payment of a royalty, for purposes of Division 3B, will occur at the time when the debt owed for the royalties is satisfied or discharged or otherwise deemed to have been paid. Payment may occur in a variety of ways e.g. by actual payment in cash or by bill of exchange, by an agreed set-off, by a transfer in kind or by an agreement between the parties which acknowledges that the amount of the royalties is to be lent by the non-resident in accordance with the terms of that agreement. By subsection 221YHZA(2), payment is deemed to have been made where, broadly speaking, money is dealt with on behalf of a non-resident or as the non-resident directs.

6. It is the general practice of this Office to regard royalty income as being derived at the point in time when a non-resident receives the royalties. Taxpayers for whom a cash basis of tax accounting is appropriate will bring royalty income to account as being derived on a cash basis. Taxpayers for whom an accruals basis of tax accounting is appropriate will also bring royalty income to account on a cash basis except, however, where the taxpayer's business, or one of its businesses, is a business of deriving royalties, in which case an accruals basis will generally appropriate.

RULING

Obligations of Royalty Payers

7. Subsection 221YHZB(1) provides that a person who is liable to make a royalty payment to a non-resident may not make that payment to the non-resident unless he has first notified the Commissioner of the amount of the royalty payment and been advised in writing by the Commissioner of the amount of tax to deduct.

8. The word "liable" is not defined in the Act and bears its ordinary meaning. According to the Macquarie Dictionary, the word "liable" is defined, as presently relevant, to mean "under legal obligation; responsible or answerable". In its context in subsection 221YHZB(1), a person is "liable" to make a royalty payment to a non-resident where the person is under a legal obligation to make the payment to the non-resident or the person is responsible or answerable to the non-resident for the payment.

9. Because a person who is liable to make a royalty payment to a non-resident may not do so without having first notified the Commissioner of its amount and been advised by the Commissioner of the tax to deduct, it is desirable from that person's point of view and from the Commissioner's point of view that notification be made to the Commissioner as soon as practicable after the person becomes liable to make the royalty payment. A person will be legally obliged to make a royalty payment, or will be responsible or answerable to a non-resident for the payment, as soon as the person accepts and acknowledges the liability to make the royalty payment. It is unnecessary to wait until the royalty payment is immediately due and payable and legally enforceable before notifying the Commissioner. It is sufficient for purposes of subsection 221YHZB(1) if the person acknowledges that the royalty payment is payable at a future time.

10. Alternatively, regular or frequent payers of royalties, or any person who is aware that he will have a liability to pay royalties to a non-resident in the future, may apply for a certificate under subsection 221YHZB(4) exempting the holder from notification under subsection 221YHZB(1) in respect of a specified payment, or payments included in a specified class (e.g. payments of a similar nature to one or more residents of a single country). The certificate is issued subject to certain conditions, including a condition that tax ascertained in accordance with the certificate be deducted before payment of the royalty.

11. Except where an applicable certificate under subsection 221YHZB(4) is held, notification is required in respect of each and every royalty payment. Where it is feasible for an Australian payer to notify the Commissioner of amounts of royalty payments due to non-resident(s) as classes of payments, this Office will notify that person wherever practicable of the amounts of tax to be deducted from those classes of payments. Failure to make the necessary notification will leave the payer of the royalties open to prosecution under subsection 221YHZB(1) where a royalty payment is made, or deemed to have been made, to a non-resident without the notification and, on conviction, to an order under subsection 221YHZB(3).

12. Section 221YHZC imposes a further duty on a person who is liable to make a royalty payment to a non-resident, and who has ascertained the amount of tax to be deducted, to deduct the required amount of tax from the royalty payment at the time of making the payment. Under subsection 221YHZD(1), the tax so deducted must be remitted to the Commissioner, together with

notification of the date on which the amount was deducted, within 14 days after the end of the month in which the person makes the payment to the non-resident. The Act imposes heavy penalties for failure to meet these obligations.

13. In all of these provisions it is the time of payment of the royalty which is critical to the operation of the section. Notification must be made before payment, tax must be deducted at the time of payment, and the tax so deducted must be remitted within a certain time of making the payment. It is therefore necessary to determine what constitutes payment, or the making of a payment, of a royalty.

Meaning of Payment

(i) Actual Payment

14. "Payment" in the ordinary sense of the word, is the act of discharging a debt, obligation, etc. as by giving or doing something, or it is the act of satisfying the claims of a person as by giving money due: the Macquarie Dictionary. In the context of Division 3B, payment is, in essence, the satisfaction of a debt owed for royalties. The most common way in which payment is made is actual payment, i.e., a sum of money or a bill of exchange is handed over directly to a non-resident to extinguish a debt for royalties. However, payment may be made in other ways such as:

(a) by an agreed set-off where cross-liabilities exist (see Spargo's case; Re Harmony and Montague Tin and Copper Mining Co. (1873) 8 Ch. App. 407 and F. C. of T. v. Steeves Agnew & Co. (Vic.) Pty Ltd (1951) 82 CLR 408 at 420-1);

(b) by a transfer of property other than money or a bill of exchange, i.e., by a transfer in kind;

(c) by an agreement which acknowledges that the amount of the royalties is to be lent by the non-resident to the Australian payer and is to be repaid to the non-resident in accordance with the terms of that agreement.

(ii) Deemed Payment

15. Subsection 221YHZA(2) makes it clear that, for purposes of Division 3B, payment is not limited to actual payment. Under this subsection, money which is reinvested, accumulated, capitalised or otherwise dealt with on behalf of, or at the direction of, the person to whom royalties are payable, is deemed to have been paid at the time that it is so dealt with. It follows that the sending overseas of funds owed in respect of royalties is not determinative of when "payment" occurs for purposes of Division 3B since there may have been a deemed payment at some earlier point in time.

16. A mere book entry showing an amount as due and payable is not of itself a payment: Aktiebolaget Volvo v. F.C. of T. 78 ATC 4317; (1978) 8 ATR 747. However, a crediting by a debtor (or payer) in his books of account which by express or implied agreement with the creditor (or payee) brings about a change in legal relations between the debtor and creditor, or evidences an agreement between the parties to replace the debt for royalties with a financing arrangement, constitutes, in the view of this Office, a deemed payment in terms of subsection 221YHZA(2). Where, for example, an amount in respect of royalties is credited to the non-resident in such a way that he obtains the benefit of the money, even though it is not actually paid over to him, there will be a payment or a deemed payment. Similarly, where royalties are credited to an inter-company loan account in the name of the payee, and the funds are retained in Australia for use by the payer, the Commissioner does not accept there is no payment until the funds are remitted to the non-resident. In these circumstances it is considered that there has been a deemed payment because the royalties have been accumulated or otherwise dealt with on the non-resident's behalf for purposes of the Division: cf Case T21 86 ATC 214; 29 CTBR (NS) Case 24 where it was held that interest which the taxpayer had an enforceable right to receive and which was credited to a loan account in her name in the books of the payer company, must be regarded as derived under section 19 because it was dealt with on her behalf, notwithstanding that she had no immediate control over the funds.

17. It has been argued that, having regard to dicta of Gibbs J in Brent v. F.C. of T. 71 ATC 4195; (1971) 2 ATR 563 concerning section 19, royalties which have been retained in Australia for use by the payer should not be treated as having been dealt with on behalf of the non-resident. There are, however, clear distinctions between Brent's case and situations where an amount in respect of royalties payable has been credited to the non-resident's loan account. In Brent's case, notwithstanding the delay in the payment of fees for services rendered, the legal relations between the company and the taxpayer remained exactly the same, i.e., the company remained under an obligation to pay her those fees. However, where an amount for royalties is credited to an inter-company loan account, the legal relations between the payer and the payee do not remain the same: the debt for royalties has been replaced by a loan arrangement. In these circumstances, the royalties are considered to have been accumulated or dealt with on the non-resident's behalf. A payment will be deemed to have been made for all purposes of Division 3B.

18. Where the books of account do not show a crediting of the royalties to the non-resident, but the reality of the situation is that the delay in the sending overseas of royalties is a de facto financing arrangement, then a payment may also be deemed to have been made. A pattern of delayed payment which has not been challenged by the non-resident payee may, in the absence of evidence to the contrary, give rise to a presumption that the retention of the funds by the payer represents a financing arrangement between the two parties. In these circumstances, the

royalties will be treated as having been accumulated on the last day for payment provided under the contract.

19. Except in the situation outlined in paragraph 18, a delay in payment, or an accumulation of debts owed in respect of royalties, even where the non-resident agrees to the delay, will not give rise to a deemed payment under subsection 221YHZA(2). For example, where a non-resident, on a one-off basis and for sound business reasons, extends credit to the payer for a short term, payment will not occur until the debt is satisfied.

Obligations of Non-Resident Recipient of Royalties

(i) Time of Derivation of Royalty Income

20. The combined effect of the definition of "royalty" in subsection 6(1) and the provisions of paragraph 26(f) is that royalties within the ordinary meaning of that term, and receipts that are royalties only by reason of the definition in subsection 6(1) and which also have the character of income, are included as assessable income under paragraph 26(f).

21. The provisions of subsection 25(1) and paragraph 26(f) are not mutually exclusive, and royalties of an income nature, whether royalties within the ordinary meaning or only by reason of the definition, may also be assessable income under subsection 25(1). Royalties which form part of the taxpayer's assessable income, irrespective of which provision applies, are assessable when they are derived by the taxpayer. The term "received" in paragraph 26(f) is not used in a narrow or technical sense and has a similar meaning to "derived" : Case V122 88 ATC 764; AAT Case 4519, 19 ATR 3750 at 3752.

22. The normal rules for determining the time of derivation of income apply in respect of royalties paid to non-residents. The actual point in time at which a royalty is derived will depend on the circumstances in which the taxpayer derives the royalty. In the case of a non-resident individual who is not carrying on a business, for example, a taxpayer in receipt of royalties from the sale of a book, it may well be that the appropriate basis of tax accounting for the royalty income would be a receipts basis. In such a case, subject to the provisions of section 19, the royalty income will be derived when it is actually received: see CITCM 862, paragraph 69.

23. Taxpayers carrying on business for whom an accruals or earnings basis of tax accounting is appropriate, C. of T. (S.A.) v. Executor Trustee and Agency Co. of S.A. Ltd (Carden's case) (1938) 63 CLR 108, may also derive royalty income, subject to the provisions of section 19, when it is actually received. However, where the taxpayer's business, or one of its businesses, is a business of deriving royalties, i.e., a business in which royalties are regularly derived in the ordinary course of the business and their derivation forms an essential part of the business, the accruals method will generally be the most

appropriate method for accounting for the royalties for tax purposes. In these circumstances, the royalty income is derived when the royalty is due (though not necessarily presently receivable) under the terms of the contract. It is not necessary that there be an actual receipt of the royalty.

24. In cases where the quantum of the royalties is not ascertainable by the non-resident payee until receipt, the royalties may be returned on a receipts basis, notwithstanding that the taxpayer carries on a business of deriving royalty income.

(ii) Lodgment of Returns

25. Notwithstanding the provisions of Division 3B concerning the collection of tax by a person making royalty payments to a non-resident, royalty payments derived by non-residents are assessed by normal assessment procedures. A non-resident taxpayer should lodge an Australian income tax return in which the royalty payments are included as assessable income in the year in which they are derived. Where an agent in Australia holds or has the control, receipt or disposal of an amount in respect of royalties belonging to a non-resident, the agent is required to lodge returns in respect of those royalties (subsection 254(1)).

26. Tax which has been collected in respect of a royalty payment under Division 3B will be credited towards the tax payable by the non-resident.

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