

STD 1999/4 - Valuation of tax advantaged computer programs in personal computers .



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Sales Tax Determination

Title: Valuation of tax advantaged computer programs in personal computers¹.

Background

Sales Tax Determination STD 96/5 *Calculation of tax payable on goods containing tax-advantaged computer programs* (TACPs), and later Addenda, were issued to help taxpayers determine which storage devices commonly contain TACPs and how those TACPs could be valued.

Discussions with the Australian Information Industry Association (AIIA) and industry representatives have indicated that, in some circumstances, taxpayers are unable to use the replacement value methodology set out in STD 96/5 when valuing TACPs bundled with personal computers.

The AIIA has also indicated that, since the introduction of STD 96/5 in April 1996, the dynamic nature of the computer industry has seen an increase in the number and value of computer programs being bundled with personal computers.

This has brought into question whether, in some circumstances, the percentage values at Point 2 of the Decision Section in STD 96/5 reflect the current value of the TACPs now bundled with personal computers. (Note: the percentage values discussed above are now termed 'Safe Harbours').

¹ The term personal computer in this ruling means goods identified in Items 1, 2, 3 and 4 of the table 'Part 7A goods' in sub-section 91C(1) of *Sales Tax Assessment Act 1992*.

In consultation with the AIIA and industry representatives, an alternative valuation methodology has been developed to assist taxpayers determine the value attributable to TACPs that are bundled with personal computers and sold by wholesale for the one inclusive price.

The methodology has been developed in accordance with the general principles contained in STD 96/5.

Issues

What is the alternative methodology that can be used to determine the value attributable to TACPs bundled with personal computers and sold for one inclusive price?

Do I have to use the alternative methodology?

Can I use the alternative valuation methodology to calculate a refund of, or claim a credit for, sales tax overpaid on sales of TACPs bundled with personal computers?

Date of effect

This Determination is effective from 1 August 1999.

Decision

Taxpayers should continue to use the methodologies outlined in STD 96/5 and its Addenda if replacement values of TACPs are ascertainable.

If replacement values are not ascertainable, taxpayers can either :

- use the percentage values (Safe Harbours) outlined at Point 2 of the Decision Section in STD 96/5; or
- use the alternative methodology outlined in this Determination.

The alternative valuation methodology can be used by taxpayers to calculate refund or credit claims on TACPs bundled with personal computers.

However, where a taxpayer relies on the alternative valuation methodology values in Appendix A to this Determination to calculate a refund or credit, the Appendix only applies to sales occurring on or after 1 August 1999.

Alternative Valuation Methodology

The ATO will list the value attributable for a number of widely distributed TACPs.

1. Widely distributed TACPs

The ATO and the AIIA have identified a number of widely distributed computer programs that are commonly bundled and sold with new personal computers. For each of these identified programs, the ATO will determine an acceptable value for use by taxpayers. These values will be based on the normal wholesale prices charged by independent computer program wholesalers for the particular program in question.

The listing of these programs and their accepted values will be published on a quarterly basis on the ATO's Internet site, ATOassist, at **www.ato.gov.au**

This new TACP valuation methodology commences on 1 August 1999.

The initial listing provides values that can be used for taxable dealings from 1 August 1999 to 30 September 1999. A copy of this initial listing is included as Appendix A. All future listings will be available on the ATO Internet site from the first day of the month immediately preceding the start of the next quarter; i.e., on the 1st day of September, December, and March.

Where the TACP bundled with the computer goods is not identified on the ATO listing.

Where the ATO listing does not identify a particular computer program that is being bundled with personal computers, the value of the TACP can be determined by reference to the wholesale price of an arm's length wholesaler who makes significant and regular sales of that particular program by wholesale to arm's length parties.

Where a taxpayer elects to use the Safe Harbour values at Point 2 of the Decision section in STD 96/5, the relevant percentage value should reflect the value of all TACPs bundled with the personal computer, even where more than one TACP is bundled.²

² Refer to Point 2 on page 3 of STD 96/5.

What are Proprietary TACPs?

2. Proprietary TACPs

Proprietary computer programs are computer programs that are developed and owned by the computer goods manufacturer and, generally, fall into 2 broad categories, *system programs* and *application programs*.

Proprietary system programs are computer programs that control the operation of the computer and include utility programs such as Sleep Manager, Power Management, Recovery Utilities, etc.

Proprietary application programs provide the computer with capabilities to perform specific tasks such as word processing, spreadsheets, data bases, games, etc.

To qualify as a TACP, the proprietary computer program must not be embodied in a microchip.³

Particular proprietary computer programs are usually sold with new personal computers of a particular computer goods manufacturer. Separate sales of these programs, if they occur at all, generally are irregular and of insignificant quantities. For this reason, they will not appear in the ATO list of widely distributed programs. However, the ATO has developed some special rules for valuing proprietary computer programs where STD 96/5 is difficult to apply. These rules are set out below.

The value attributable to proprietary TACPs sold by wholesale.

Where a developer or distributor from that developer does make separate, significant and regular wholesale sales of the particular proprietary computer program in arm's length circumstances, the wholesale price of those sales is the appropriate value to attribute to the TACP.

The value attributable to proprietary TACPs sold by retail.

Where the developer or distributor only makes separate sales of a particular proprietary computer program by retail, and the cost⁴ of the computer program can be determined, the value to be attributed to the TACP can be the sum of the cost of the computer program plus one-third of the difference between that amount and the retail selling price of the program.

³ See subsection 14(1) of *Sales Tax Assessment Act 1992*.

⁴ Where the value of the proprietary TACP is being calculated by the developer of the computer program, the cost will be the sum of the cost of materials, plus direct labour costs plus production overheads, including associated research and development costs. Where the value of the proprietary TACP is being calculated by a distributor of that TACP, cost is the into store cost of the TACP which means the acquisition price of the TACP plus any other directly attributable costs of acquisition of the TACP. In identifying the acquisition price of the TACP, only rebates identified at paragraphs 2.18 and 2.19 of Sales Tax Ruling SST 6 can be deducted from the invoice price.

Where the proprietary TACPs are not sold by wholesale or retail, the following values can be used.

Where a separate wholesale selling price, or either the into-store cost or the retail selling price of a proprietary computer program is not ascertainable, the value to be attributed to the proprietary TACP should be:

- for System TACPs - one half of one percent ($\frac{1}{2}\%$) of the wholesale value of the personal computer.
- for Application TACPs - one percent (1%) of the wholesale value of the personal computer.

The total of the values attributed to the proprietary TACP by this last rule is limited to a *maximum of 3%* of the value of the personal computers with which they are bundled.

Where taxpayers can determine the value attributable to proprietary computer programs using either the wholesale value method or the 'cost plus' method described above, then these values will not form part of the 3% maximum limit.

Principles underlying the Valuation Methodology

The value attributable to the TACP must be determined having regard to the particular licensing agreement under which it is distributed.

The value to be attributed to a particular TACP must be determined by reference to the type of distribution agreement and licence under which that TACP is marketed. For instance, an Original Equipment Manufacturer (OEM) program should be valued by reference to the wholesale value of the same program distributed under an OEM licence agreement. It is not appropriate to attribute the wholesale value of an 'off the shelf' version or other non-OEM computer program.

For instance, where an OEM version of Microsoft Windows 95 is bundled with a personal computer which is sold for one inclusive price, the value to be attributed to this TACP is the wholesale value of the OEM product, not the wholesale value of other non-OEM versions of the computer program.

Can I value a TACP by reference to the value of a similar computer program?

Taxpayers cannot value one computer program by adopting the value of a different program even though they may perform broadly similar functions. The reason is that programs which might in some instances perform similar functions, may still have different levels of functionality and may be distributed under different licensing arrangements. The values attributable to these programs, therefore, could vary greatly.

TACPs sold in bundles or packs.

Often, two or more computer programs are marketed and sold together for one inclusive price. For example, Microsoft Internet Explorer program may be included with the Microsoft Windows 95 or 98 product and sold for one inclusive price. In other instances, computer programs will be marketed as a product which may be referred to as a 'bundle', 'pack' or 'suite', i.e., Microsoft Home Pack, Lotus Smartsuite, IBM Office in a Bag, etc. The bundled products, generally, will have their own distinct product code and commercial identity.

Bundled computer program products are to be valued by reference to the value of the bundled product.

The value attributable to the bundled computer programs product will be the value of the bundled product and not the sum of the values of the individual products which make up the bundle. The reason is that the individual programs which comprise the bundled product are being sold, effectively, at a discount.

For example, two programs, A and B, have individual wholesale prices of \$52 and \$48 respectively. However, both programs are also sold together as a pack entitled 'XYZ Home Pack' for a wholesale price of \$80. The two programs have been discounted, effectively, by 20% through being sold as a package. The value to be attributed for 'XYZ Home Pack' is the value attributed to the bundled product (\$80), not the sum of the individual programs' values (\$100).

Substituting TACPs within a bundle or pack. In some instances, a taxpayer tailors a commercially recognised computer program bundle or pack by substituting one or more titles within the pack with other program titles. In these circumstances, the value of the original bundle of titles may be used to value the tailored bundle where:

- two or more of the highest value programs are common to the two bundles; and
- the bundles are distributed under similar types of licence agreement.

Example 3 in Appendix B illustrates the operation of this principle.

Where the TACP and personal computer are sold at a discount Where the price of the bundled TACP and personal computer is discounted, the discount will be applied to the TACP and computer goods component of the sale to maintain the same ratio of TACP to computer goods.

For example, if a taxpayer who normally wholesales a personal computer for \$2,500 (including \$500 of TACP), discounts the price by 20% to \$2,000, the TACP component of the assessable dealing is reduced by 20% to \$400.

Refunds & Claims for Credits of sales tax overpaid The alternative valuation methodology can be used by taxpayers to calculate refund or credit claims where sales tax has been overpaid on sales of TACPs bundled with personal computers. However, where a taxpayer relies on Appendix A to calculate a refund or credit, the Appendix only applies to sales occurring on or after 1 August 1999.

To determine the amount of any overpayment, the value to be attributed to the TACP will be ascertained by reference to those values in existence at the time of the assessable dealing.

For example, if the bundled sale of the TACP took place in July 1997, then the value to be attributed to the TACP would be the July 1997 value of the TACP.

Keeping records Taxpayers must keep adequate records in order to record and explain how the sales tax payable on any taxable dealings with personal computers has been determined⁵.

⁵See Section 127 of the *Sales Tax Assessment Act 1992*

Reasons

We have based our decision on the following:

Section 14 of the Sales Tax Assessment Act 1992

Section 14 of the *Sales Tax Assessment Act 1992* (STAA) defines a TACP as a computer program that is embodied in a storage device, other than a microchip. Computer programs for educational or entertainment use that are embodied in microchips will also be tax-advantaged where the microchip in which the program is embodied is contained in a cartridge that is marketed exclusively for use with a personal computer and/or home electronic device that is for use with a computer monitor or television screen.

Once it is established that a computer program is a TACP, it is then necessary to determine the value attributable to the TACP.

Section 45 of the Sales Tax Assessment Act 1992

Section 45 of the STAA provides that where a computer program is tax-advantaged, the taxable value of the goods in which the program is embodied that are the subject of an assessable dealing, will be reduced by the value of the program. The reduction in taxable value is described as an exempt part of the taxable value.

Sales Tax Determination STD 96/5

STD 96/5 ruled that the value attributable to the TACP is the replacement value of the TACP. For widely distributed programs, the replacement value is the wholesale value of a replacement program supplied under the same licensing agreement. This principle of valuing like with like is one of the underlying principles in the alternative valuation methodology in this Determination.

Addendum to Sales Tax Determination STD 96/5

However, we recognised in the answer to Question 1 of the first Addendum to STD 96/5 that, in some circumstances where taxpayers made significant sales of a TACP by wholesale, this value could be used to determine the value attributable to the TACP.

Taxation Ruling TR 93/12

Taxation Ruling TR 93/12 considers the nature of rights associated with computer programs and discusses the various methods by which computer programs may be distributed. The ruling recognises that payments for the purchase of a copy of a computer program, usually, are for a licence to use the computer program and for property in the carrying medium.

The most common type of licence agreement under which computer programs are bundled with personal computers are OEM licences. Under these arrangements, the end user is granted a licence to use the computer program, i.e., to run the program, or to make a back up copy of the program, and limits the user's rights to deal with the program. Licence agreements are a common means by which developers of computer programs protect the commercial value of those programs.

TACPs that are distributed under the terms of a particular licensing agreement may be valued by reference to the wholesale value of the identical TACP distributed under that particular licensing agreement.

Communication of the Decision

This Determination has been made available for publication by the sales tax publishing houses. It will also be made available to the AIIA for distribution to its members.

Commissioner of Taxation

21 July 1999

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STD 95/2, STD 96/5; STD 96/5 Addenda, SST 6, TR 93/12

Subject references:

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Legislative references:

STAA: sections 14, 45 and 127

ST(E&C)A: Item 1 in Schedule 4

ATO references:

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APPENDIX A**Values Attributable to Tax Advantaged Computer Programs widely distributed with new personal computers Valid from 1 August to 30 September 1999.⁶**

Manufacturer	Product Description	Manufacturer's Product Code	Value \$
Edmark	Bailey's Book House	1575	38.00
	Thinking Science - Zap	1896	49.00
	Crayola Make A Masterpiece	3042	35.00
IBM	Via Voice 98 Home Edition	99J0025	69.00
	World Book Encyclopedia 99 Deluxe		74.00
	World Book Encyclopedia 99 Standard		36.00
	World Book 99 Family Reference Suite		108.00
	IBM Antivirus OEM		44.00
	Office in a Bag (incl Lotus Smartsuite 97, VoiceType Simply Speaking, IBM Antivirus Desktop Ed IBM World Book Encyclopedia Deluxe Edition)	09L6768	74.30
Intuit	Quicken 7.0	INW-QK-WV7	59.50
	Quicken Deluxe 7.0	INW-QK-WV7DLX	74.50
Lotus	Smartsuite 97 OEM	I080580/10/P20	10.00
	Smartsuite Millennium Edition	AN9QTIE	101.00
McAfee	VirusScan Classic V4.0	VSF-CD01-NA-400	58.00
	VirusScan Deluxe V4.0	VSL-0001-AP-400	74.00
Microsoft	MS Windows 95 OEM + IE4.0	362-00550	139.00
	MS Windows 95 OEM + PRESS + IE4.0	362-00843	159.00
	MS Windows 98 OEM	A66-00007	138.00
	MS Windows NT 4.0 Workstation OEM	A26-00001	277.00
	MS Windows NT 4.0 Server OEM	227-01260	953.00
	MS Office Small Bus Ed. OEM	588-01017	320.00
	MS Works 4.5A OEM	070-01019	38.00
	MS OEM Works Suite 99 (incl Word 97, Encarta 99 World Atlas, Works 4 5, Works Calendar, Money 99 Basic, Graphics Studio Greetings & Expedia Streets)	B11-00101	132.00
	MS Home Essentials 98 OEM Pack (inc Word 98, Works 4.0, Encarta 97, Greetings Workshop, IE 4.0 and Arcade and Internet Gaming Zone)	583-00141	132.00
	MS OEM Games Pack (incl Age of Empires, Golf 4 0, Monster Truck Madness & Return of the Arcade)	B73-00005	56.00
	MS OEM Consumer Pack (incl Encarta Encyclopedia 99 and Pinball Arcade)	A61-00001	46.00
	MS Encarta 99 Reference Suite (incl Encarta 99 Encyclopedia Deluxe, Bookshelf 99 & Encarta World Atlas 99)	844-00038	148.00
	MS Money 99	105-00226	40.00⁷
	MS Graphics Studio Greetings 99	A99-00008	36.00*
	MS Encarta 99 Encyclopedia Standard	196-00282	36.00*
	MS Encarta 99 Encyclopedia Deluxe	450-00085	106.00*
	MS Encarta World Atlas 99	219-00102	68.00*
Symantec	Norton AntiVirus Gold Edition 5.0	5390077260960	74.00
	Norton AntiVirus Gold Edition NFR	07-00-02312-AU	49.00
Vet	Vet Antivirius OEM	1400CD	5.00
Websters	Australian Multimedia Education Pack	OEM-ED2	19.00
Corel	Corel WP Suite 8 OEM (single unit value)	WPS800Vars5INTOJC	57.60
Corel	Corel WPS8 W/Dragon OEM (single unit)	WPSD80Vars5INTO	100.00

⁶ The ATO listing can be viewed at www.ato.gov.au. Lists will be updated quarterly, the next becoming available on 1 September for the period 1 October 1999 to 31 December 1999.

⁷ This value may only be used where the computer program is a stand alone product i.e. not part of a software bundle, suite or pack. See pages 6 and 12 for more information on computer program bundles, suites or packs.

* As per 7 above

APPENDIX B

Examples to Demonstrate the Practical Application of the Alternative Valuation Methodology

Example 1:

A taxpayer imports fully assembled personal computers bundled with computer programs. The importer sells the goods by wholesale to retailers for \$1,500 but is unable to determine the replacement value of the TACPs under valuation methodologies prescribed in STD 96/5. Under the alternative methodology described in this Determination, the following values can be attributed to the TACPs.

TACP	Value \$	How Determined:
Microsoft Windows 95 OEM + IE4.0	139.00	From ATO listing.
Lotus Smartsuite 97 OEM	10.00	From ATO listing.
Microsoft Encarta 99 Reference Suite	148.00	From ATO listing.
Vet Anti-Virus OEM	5.00	Computer program wholesaler's price.
Power Management Program	7.50	Proprietary operating program ⁸ .
Total TACP value	309.50	

Calculation of the sales tax due on a taxable dealing with the goods using the above values:

Components of the Calculation	Value \$
Wholesale selling price of goods	1,500.00
Less: Value of TACPs	309.50
Net Taxable value	1,190.50
Sales Tax @ 22%	261.91

Example 2:

The taxpayer distributes laptop computers by wholesale that are acquired from an overseas manufacturer. The computer and bundled computer programs are sold to retailers for \$3,000. A number of proprietary programs have been bundled by the manufacturer. One of these proprietary programs is also acquired by the taxpayer and sold by retail separately. Under the alternative methodology described in this Determination, the following values can be attributed to the TACPs.

TACP	Value\$	How Determined:
Microsoft Windows 98 OEM	138.00	From ATO listing.
Lotus Smartsuite 97 OEM	10.00	From ATO listing.
Proprietary Anti-Virus	30.00	Cost \$20 Retail \$50. Value is cost plus 1/3 difference retail-cost rule for proprietary programs.
Power Management Program	15.00	Proprietary operating program.
Total TACP value	193.00	

⁸ The value for the proprietary operating TACP is calculated as 0.5% of the wholesale selling price of the personal computer

Calculation of the sales tax due on a taxable dealing with the goods using the above values:

Components of the Calculation	Value \$
Wholesale selling price of goods	3,000.00
Less: Value of TACPs	193.00
Net Taxable value	2,807.00
Sales Tax @ 22%	617.54

Example 3:

A taxpayer manufactures personal computers which are to be sold by wholesale. The taxpayer requests the supplier of the computer programs to vary the titles in the Microsoft Home Essentials and Microsoft Home Packs, one of which he normally bundles with his personal computers. He requests that Works and Encarta remain in both packs but other titles in the pack be varied. He also bundles Windows 98 (value attributable \$138).

The taxpayer sells the bundled TACPs and computer goods by wholesale for \$1,500. The taxpayer looks at the ATO listing of computer programs and their values but can not find a computer program pack with the same titles that he has bundled with his computers.

The table below shows the titles commonly found in a pack and the titles the taxpayer had included in the pack to be bundled with computers he manufactured for sale by wholesale.

Pack or Bundle	Titles in Ms Pack (ATO Listing)	Client Pack of TACPs	Value Attributable
Microsoft Home Essentials	<i>Word 98, Encarta 97, Works 4.0, Greetings Workshop, IE 4.0, Arcade & Internet Gaming Zone</i>	<i>Word 98, Encarta 97, Works, Money 98, Publisher 97, Truck Madness, Golf.</i>	\$132 (from ATO listing)
Microsoft OEM Works Suite 99	<i>Word 97, Works 4.0, Encarta 99 World Atlas, Works Calendar, Money 99 Basic, Graphic Studio Greetings, & Expedia Streets.</i>	<i>Works, Encarta, , Money 98, Word, Fast Photos, Bookshelf 99, Golf 4.0</i>	\$132 (from ATO listing)

It would be appropriate for the taxpayer to adopt the value of the Home Essentials or Works Suite pack where two or more of the predominant value TACPs are similar. It would not be appropriate to value the individual titles in the pack. The appropriate value to be attributed to the bundled pack of computer titles would be \$132. The sales tax due on the sale would be:

Components of the Calculation	Value \$
Wholesale selling price of goods	1,500.00
Less: Value of TACPs (\$138+\$132)	270.00
Net Taxable value	1,230.00
Sales Tax @ 22%	270.60