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TAXATION ON *SOFTWARE*

Dispute Resolution nº 27/2008 of Brazilian Federal Revenue

In the taxation field, the application given to software still involves some controversy that is related mainly to the absence of solid concepts by principles, jurisprudence and also by the tax law.

Despite these problems and after years of discussions involving the taxation of 'off the shelf' software, Federal Revenue of Brazil acknowledged that the amounts issued abroad for payment of acquisition or licensing of software in multiple copies (off the shelf software) are not subject to Income Tax levy and to the Federal contribution for intervention in the economic domain (CIDE).

Through the dispute resolution nº 27, dated on May 30th 2008 and published in the Official Gazette of 9th June 2008, the Federal Revenue of Brazil presented different interpretation from that one which has been applied to the provisions of the Federal Revenue regulations - RIR (Decree nº 3000 of March 26, 1999) and the Ministry of Treasury Ordinance nº 181/89 concerning the IRRF levy on remittances to foreign countries for payment of 'off the shelf' software.

Regarding the CIDE levy, the interpretation has not presented changes in practice, since the law related to the contribution had already been amended by Law nº 11.452/07, conciliating the non-levy of this contribution on the remuneration for the license of use or rights for trade or distribution of computer program, which does not involve the transfer of corresponded technology.

This study aims to clarify some aspects of the taxation conflict in transactions involving software, especially after the recent publication of the Dispute Resolution nº 27/2008, which in practice has brought other disagreements regarding the tax application.

I Dispute resolution nº 27 - May 30, 2008

As mentioned, the most recent change in tax application given to operations with software refers to the IRRF and CIDE levies on the values remitted abroad for acquisition of 'off the shelf' software.

The dispute resolution nº 27/2008, signed by the General Coordinator of the Federal Revenue Service of Brazil, acknowledged that the amount issued to foreign countries for 'off the shelf' software "are not subject to the levy of Income Tax (IRRF) neither of the CIDE for the acquisition or licensing of multiple copies software".

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I. Withholding Tax - IRRF

The interpretation presented by the dispute resolution nº 27/2008 is expressive regarding the withholding tax income (IRRF), as it represents 15% on remittances abroad, as payment for purchase of "off the shelf" software.

The software, as you know, is based on a creative activity of the developer, and that is the motive its protection has copyright exemption, although in Brazil there is a specific law addressing the issue. Therefore, the legal relationship established between the software intellectual owner and the software itself is ruled by the copyright.

The amounts paid, credited, delivered, used or issued to a resident or domiciled abroad, resulted from the contract of assignment for rights of use and license, as copyrights, as well as the software maintenance, they characterizes royalties payment.

In this sense, the regulations of the Income Tax - RIR (Decree nº 3000, dated on March 26th 1999), establishes in its article 710 that the amounts paid, credited, delivered, used or issued to foreign countries for royalties from any nature are subject to Withholding Tax, at the rate of 15%, except for the possibility of application of the rate of 25%, if the destination country is considered a "tax haven".

Thus, remittance of values abroad as royalties for licensing of software will result IRRF rate of 15%, as well as 10% of CIDE.

The matter in question would not produce much controversy, except because of the rule that determines the non-levy of IRRF on abroad remittances for payment of software acquisition, unlike the software developed ‘to order’. It is because - for this kind of software – remittances are not classified as royalty, as this is considered good and not copyright.

Although this classification does not find legal support, law allows the existence of distinction between ‘off the shelf’ software and software ‘to order’.

The software “off the shelf” or "multiple copies" is commonly defined as the computer program produced on a large scale, in a uniform way and placed in the market for acquisition by any person.

Accordingly, the legal understanding is that the trade of a copy or copies of computer programs produced and commercialized in mass for retail - materializing the c*orpus mechanicum* of the intellectual creation of the program - is trade of goods.

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Also, 'software to order' – for proper user and specific purpose – is classified by law as service, supported by the Complementary Law 116/2003.

According to the mentioned Law, the "development of computer programs is subject to the tax levy on services ("ISS"), including electronic games and licensing or assignment for right of use computer programs". In the topic below (item I.b), we will discuss some issues on the ISS levy in operations of software licenses and assignment of rights.

According to the legal understanding on the distinction of the 'off the shelf' software - that is qualified as goods - it is not necessary to discuss about the IRRF levy, as the consideration for the acquisition of such software is not related to the payment of royalties.
Therefore, the idea brought by the dispute resolution consolidates the legal conviction to not claim the abroad remittances for the acquisition or licensing of 'off the shelf' software, without withholding and payment of IRRF and CIDE.

I.b – Tax on Services - ISS

As mentioned above, the simple addition of a certain activity in the list of services subject to the ISS levy is not enough to make such activity as a service. In fact, it is necessary that such activity constitutes rendering of services. And it is questionable the classification of the assignment of rights and licensing of software as services, subject to the ISS levy.

The Complementary Law 116 from 31/07/03 has several changes, nationwide, among them the charge of ISS related to "licensing or assignment of right to use a computer program" - item 1.05 in the list attached.

ISS has its constitutional pattern ruled by Article 156, III of Federal Constitution, which Municipalities establish the tax on services from any kind, not included in art. 155 - II.
The substantive criterion of tax on services is connected to the rendering of services, as already provided in Article 8 of Decree Law nº 406/68 and also as determines Article 1 of the Complementary Law nº 116/03.

In order to clarify this material criterion - rendering of services - the Tax Law applies the conception of the law of obligations, in particular, the distinction between the obligation to do and not to do.

In that sense, the substantive criterion of the Tax on Service (ISS) could never contemplate any sort of obligation to do - or even obligation not to do, since it is an obligation - which is

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reflected in the rendering of services contained in the tax assumption.

As mentioned above, with the institution of Complementary Law nº 116/03, the legislator attempted to embrace the activity of "licensing or assignment of right to use a computer program" as a possibility of ISS levy. The computer program, the content of the provisions in Article 1 of Law nº 9.609/98 "is the expression of an organized set of instructions in natural or coded language, contained in the material of any kind, necessary work in automatic machines of information processing, devices, peripheral instruments or equipments, based on digital technology or similar, in order to make them work for particular purposes."

The Law nº 9.609/98, which regulates the intellectual property of computer programs, adds in its Article 2 that the system of intellectual protection is the same in the literary works. And these literary works, as in Article 3 of Law nº 9.610/98, are considered movable assets - for legal purposes.

Thus, such goods are liable to have their ownership transferred to third parties, which occurs through the "agreement of assignment of rights to computer program", which are transferred, in whole or in part, the copyright holder to others.

In Brazil, as many countries, hiring the use of computer programs is made by the "license and use agreement" (licensing), and it was approved by Article 9 of Law nº 9.609/98.

So, the license to use or assignment of right for computer program is not presented as an obligation to do, but an obligation to give, by consideration or not (remunerated or free).

The assignment of rights or licensing involves the provision of software for use of a third party, on a temporary basis, so that the property is kept with the original owner.

Thus, there is not rendering of services in the licensing of software - without the effective addition of other services (consulting, customization, etc.) - but merely permission, remunerated or not, for the right of use of a work from a third party and its regulations (rights and obligations).

Federal Supreme Court decided to judge – in the extraordinary appeal nº 116.121- the ISS levy unconstitutional in the activity "movable property leasing", as such activity is a obligation to give, in temporary availability.

Before the brief arguments exposed, those companies that receive revenue arising from sale or license to use computer programs may have the approval of non-levy on ISS for future

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periods, as well as claim the refund of amounts already collected, by proposal of appropriate suit.

I.c Contribution for intervention in the economic domain (CIDE)

Regarding CIDE, the dispute resolution has not brought alterations, as Law nº 11452 from February 28th 2007 had already changed the interpretation of Article 2 of Law nº 10168, from December 29th 2000, amended by Law nº 10332 from December 19th 2001, which established the CIDE-Royalties.

The article 20 introduced the Paragraph 1-A to Article 2 of Law nº 10.168/00, stating that there will be no levy of CIDE on the remuneration from licensing of use or rights in trading and distribution of computer program, unless it involves the transfer of technology.

CIDE on royalties was created to finance technological development in Brazil, with 10% on the remuneration paid by Brazilian companies to foreign suppliers, basically software.

Since its creation - by Law nº 10.168/00 - taxable event (transfer of technology) admitted a number of interpretations, considering that any software licensing abroad was taxable event.

Law nº 11.452/07 provided solution to this problem by adding a provision which clarify that the simple acquisition of a computer program does not mean transfer of technology, but in fact a tool to the purchaser. The effective "technology transfer" only occurs when the software is purchased with access to source code.

In this sense, since the alteration of Law nº 11.452/07, there is not CIDE levy on called "off the shelf software", as it is not considered transfer of technology. There is not practical application regarding CIDE for the interpretation of dispute resolution nº 27/2008.

II Taxation on the software importation

We verify that the classification of the software as customized or "off the shelf" results different tax consequences, so that it determines the taxes levy on the operation.

In that sense, we present a summary of taxation on the software importation, in the current applicable law.

II.a Customized Software

The Customs Valuation Agreement determines that, in the case of software import, the importation tax is calculated only on the value of the material, regardless the

value of the program contained therein, following the logic that the tax levies only on the 'goods', which in this case is only the media which was recorded the computer program.

So, in order to apply the rules of the Customs Valuation Agreement on the import of software, it is necessary that the value of the material be separated from the computer program value that was recorded. In general, this material has negligible value, compared to the value of the service contained therein.

However, the invoice should indicate the cost or value of the material separately - if any - from the cost or value of the computer program.

It important to highlight that, although the Federal Supreme Court has already expressed the non-levy of ICMS on customized software, the State of Sao Paulo approved the Decree nº 51619 of February 27th 2007, which presents similar text to the previous decree regarding the same subject - in force since 2002 - determining that "in operations with computer program (software), customized or not, ICMS will be calculated on a rate that will correspond to the double of the market value of its material".

Thus, in this type of import, the value of material will have taxes due levy on the importation of goods (Import Tax - "II" + Tax on Industrialized Products - "IPI" + PIS/PASEP + COFINS + ICMS), and the value of program will have taxation when the conclusion of the financial remittance abroad.

The mentioned Article 9 of Law of Software, which is in full compliance with the rules of international law, defines that the computer program will be subject to the license agreement, and the value remitted for payment of the software license corresponds to payment of royalties.

The remittance for payment of software license will be subject to the IRRF levy at rate of 15% and to the payment of CIDE at the rate of 10%, besides the contributions to PIS-importation and COFINS-importation, at rates of 1.65% and 7.6% respectively.

Moreover, current legislation and jurisprudence classify the software license as rendering of services - subject to ISS levy - according to Complementary Law 116/2003. In the city of Sao Paulo, the rate expected for the license is 2%.

Summarizing, the taxation for importation of customized software will be as follows, in the table below:

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Importation of customized software	
Total amount (software + material)	100,00
Software value (service)	99,00
Material deduction value	1,00
19% of II, on the material;	0,19
17.5% of IPI, on the material	0,17
18% of ICMS, on the double of market value of material	0,36
2% of ISS	1,98
15% of IR	17,65
10% of CIDE	11,11
1.65% of PIS-importation	1,97
7.6% of COFINS-importation	9,70
Total	143,13

II.b ‘Off the shelf’ Software

In the importation named "off the shelf software" there will be levy of ICMS, also calculated on a basis that corresponds to the double of the market value of its material.

Based on Federal and State legislation, there will be II, IPI and ICMS levy on importation of "off the shelf software" for the material only, in case it is deducted. If there is no deduction on the material, the levy will be on the total value of the transaction.

Moreover, PIS-importation and COFINS-importation will levy rates of 1.65% and 7.6%.

Under the recent dispute resolution nº 27/2008, discussed above, there will be no IRRF and CIDE on the values remitted abroad for payment of acquisition or licensing software trading, in multiple copies (off the shelf software).

Summarizing, the taxation in case of ‘off the shelf software’ importation - with deduction of the material - will be as follows:

Importation of ‘off the shelf software’	
Total amount (software + material)	
Software value	
Material deduction value	
19% of II, on the material, if deducted	
18% of ICMS, on double of the material market v deducted	
1.65% of PIS-importation	
7.6% of COFINS-importation	
Total	

In the case of importation of ‘off the shelf software’ - without deduction of the material - will be as follows:

Importation of 'off the shelf software’	
Software value (value of the transaction)	
19% of II	
17.5% of IPI	
18% of ICMS	
1.65% of PIS-importation	
7.6% of COFINS-importation	
Total	

However, it is necessary to be careful with

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software classification, since there is not a exact conception given both by the legislation and jurisprudence, often due to lack of technical knowledge on the subject.

Our Tax Law team in Almeida Advogados remains at your disposal for any additional information deemed necessary.