Inland Revenue
Te Tari Taake

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY | HUKIHUKI HURANGA - MŌ TE TĀKUPU ME TE MATAPAKI ANAKE

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Send feedback to | Tukuna mai ngā whakahokinga kōrero ki Public.Consultation@ird.govt.nz

Notes | Pitopito kōrero

When finalised this item will update and replace the Commissioner's Interpretation Guideline published in 2003 *Non-resident software suppliers' payments derived from New Zealand—Income tax treatment* (IG0007).

While the update retains IG0007's guidance on the classification of different types of software transaction, it has been revised and reorganised to improve clarity and reflect a more modern format. No change to the Commissioner's existing interpretative position is intended. The existing interpretation accepts that the finance lease rules may apply to some leases of copyrighted articles. The Commissioner recognises this may produce unintended outcomes in some situations and is considering possible policy solutions.

A key update is that the guideline now includes a new classification for cloud computing transactions and an expanded discussion of the involvement of market intermediaries in such transactions.

A further update from IG0007 is that the former's "development or modification services" classification has been expanded to include additional services arising in cloud computing contexts.

INTERPRETATION GUIDELINE | ARATOHU WHAKAMĀORI

Income Tax – Non-resident software suppliers' payments derived from New Zealand

Issued | Tukuna: Issue date

IG XX/XX

This interpretation guideline addresses payments made by New Zealand entities to non-residents in connection with software transactions. Its focus is on explaining the principles behind the classification of common types of software transactions. It also outlines the relevant income tax implications of those transactions under New Zealand law, including the impact of double tax agreements (DTAs).

All legislative references are to the Income Tax Act 2007 (the Act) unless otherwise stated.

REPLACES | WHAKAKAPIA

- **IG0007:** Non-resident software suppliers' payments derived from New Zealand – income tax treatment

Contents | Ihirangi

Introduction | Whakataki

1. Interpretation guidelines set out the Commissioner's approach to areas of law with tax implications, clarifying interpretative issues for practitioners, taxpayers and Inland Revenue personnel. This guideline explains the approach to classifying payments made by New Zealand resident customers or distributors to non-residents under common software transactions.[1]

2. After identifying the proper character and classification of a software transaction, this guideline summarises at a high level the relevant income tax implications for the parties. These include whether payments are treated as royalties, business or rental income, services income or are non-taxable. The focus, however, is on classifying the

[1] For the purposes of this guideline, "computer program" means "encoded instructions that cause a computer to perform a particular task or produce a particular result". The terms "computer software" and "software" refer to both "computer program" (singular) and "computer programs" (plural).

transactions. The discussion of potential tax outcomes is necessarily general in nature, and a detailed analysis is outside the scope of the guideline.

3. The precise tax treatment of a particular software transaction depends on the specific facts of each case, including:

- the tax status and circumstances of the payer; and
- whether the non-resident:
  - conducts business in New Zealand;
  - is a tax resident of a country that has a DTA with New Zealand;
  - has a permanent establishment in New Zealand.

4. The following software transaction classifications are discussed in this guideline:

- supplies of cloud computing services;
- sales of copyright rights;
- licensing of copyright rights;
- sales of copyrighted articles;[2]
- leasing of copyrighted articles;
- supplies of know-how; and
- supplies of development, modification or other services.

5. The classification of these transactions is broadly consistent with the following international approaches:

- The Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital* ("the OECD Model"); [3] and
- United States regulations from Internal Revenue Service, Department of Treasury Classification of Digital Content and Cloud Transactions (sections 1.861-18 and 1.861-19).[4]

6. Payments made to a non-resident under the above classifications are generally characterised as being for the:

[2] A copyrighted article is a copy of a program, whether it is embodied on a physical medium (ie, a disk) or is transmitted by electronic means.

[3] Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital 2017 (Full Version)*, (OECD Publishing, Paris, 2019).

[4] Internal Revenue Service, Department of Treasury (US), Classification of Digital Content Transactions and Cloud Transactions *Federal Register* Vol 90, No 8 (January 2025): 2977.

- provision of services (cloud computing services or development, modification or other services);
- sale of a capital asset (sale of copyright rights);
- use of, or right to use, intellectual property (IP) or know-how (licensing copyright rights or the supply of know-how);
- sale of goods (sale of copyrighted articles); or
- lease of goods (leasing copyrighted articles);

7. There are some exceptions to the above characterisations. The most significant exception is where a cloud computing transaction involves a New Zealand entity acting as a reseller of the services to New Zealand customers. In that circumstance, the relevant payment is the payment between the New Zealand reseller and the non-resident cloud computing services provider. While these payments are generally characterised as payments for the supply of services (as occurs when no reseller is involved) there may be some circumstances where the payments may be both for the provision of services and the use of, or right to use IP or know-how (see discussion of market intermediaries and value-added resellers from [102]).
8. Tax implications of these characterisations are generally:
   - business, rental or other income with a New Zealand source (provision of services or sales and leased of goods);
   - non-taxable income (sales of a capital asset); and
   - royalites (the use of, or right to use, IP or know-how).
9. Withholding tax obligations may also arise for those making payments to non-residents where the payment involves:
   - non-resident passive income; or
   - schedular payments to a non-resident contractor.
10. Non-resident passive income gives rise to non-resident withholding tax obligations. These may arise in respect of royalties and in limited cases where a lease of a copyrighted article falls within the finance lease rules and a portion of the payments is treated as interest.
11. Schedular payments to a non-resident contractor give rise to non-resident contractors' withholding tax obligations. These obligations may arise in cloud computing arrangements in limited cases and in other supplies of services where personnel in New Zealand are involved. They may also arise in arrangements where copyrighted articles are leased.
12. In all cases, the tax implications may be modified where a double tax agreement applies (see from [65]).

13. See the appendix to this interpretation guideline for an outline of the transaction classifications and potential tax implications.

Preliminary points about software transactions

Tax outcomes turn on a transactional analysis approach

14. As stated, this guideline focuses on payments made by New Zealand resident customers or distributors to non-residents under common software transactions. The tax implications of a transaction – such as a software transaction – depend on the specific terms of the agreement and surrounding circumstances. Before determining the tax outcomes, it is essential to understand the true nature of the legal arrangements that the parties enter into and carry out. Unless the transaction is a sham or involves tax avoidance, tax implications are not based on broad notions of substance, overall economic consequences or hypothetical alternative transactions.

15. The Court of Appeal explained this approach in *Finnigan*:[5]

> **The legal principles governing the characterisation of transactions and payments made under transactions are well settled.** Parties are free to choose whatever lawful arrangements will suit their purpose. **The true nature of their transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and carried out. That does not turn on an assessment of the broad substance of the transaction or of the overall economic consequences to the parties or of legal consequences which would follow from an alternative course which they could have adopted but chose not to do. It is the legal character of the transactions that are actually entered into and the legal steps which are followed which are decisive.** The only exceptions to those principles are where the essential genuineness of the transaction is challenged and sham is established and where there is a statutory provision such as s 99 of the Income Tax Act 1976 [s BG 1] mandating a broader or different approach which applies in the circumstances of the particular case.
>
> [Emphasis added]

16. In *Ben Nevis*, the Supreme Court also referred to this principle, noting that labels parties attach to a transaction may not be important:[6]

> [47] In proceeding in this way, the Court must also respect the fact that frequently in commerce there are different means of producing the same economic outcome which have different tax consequences. **When considering the application of a specific tax provision, before reaching any question of avoidance, the Court is**

[5] *Finnigan v CIR* (1995) 17 NZTC 12,170 (CA) at 12,173–12,174.

[6] *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115.

concerned primarily with the legal structures and obligations the parties have created and not with conducting an analysis in terms of their economic substance and consequences, or of alternative means that were available for achieving the substantive result.

[48] On the other hand, it is the true meaning of all provisions in a contract that will determine the character of a transaction rather than the label given to it. **The label "licence premium" is accordingly not what is important in the present case, but rather the true contractual nature of the legal rights for which payment is to be made and the effect of applying the tax legislation to a payment of that character.** Once the nature of the contractual rights and obligations has been determined in this way, the specific provision can be applied.

[Emphasis added]

17. In *Buckley & Young*, the Court of Appeal held that the starting point in examining a transaction is the documentation expressing the transaction. However, the court continued, stating the documentation may not be determinative, especially if it is silent or equivocal on a matter. It may be necessary to assess what a payment is calculated to effect from a practical business point of view. The court stated: [7]

> **Analysis of the documentation may not determine the true character of the payments made.** Indeed, the contract may be silent or equivocal as to the quality which ought to be attributed to the payment in question. In that situation evidence of surrounding circumstances may be of particular significance in determining what the contractual expenditure is calculated to effect from a practical and business point of view.
>
> [Emphasis added]

18. Arrangements may comprise more than a single agreement. Separate contracts do not necessarily mean there are multiple software transactions. It will depend on the circumstances in each case, particularly, whether there is an interdependence of rights and obligations under the contracts.[8]

19. Accordingly, it is essential to determine the legal rights and obligations that arise from a transaction. This may require examining multiple documents, particularly in the context of cloud computing transactions with large multinational software providers. What matters is the legal effect or the legal substance of the transaction, not its overall economic effect or the form or language used to describe it. While reviewing any documentation evidencing the transaction is the starting point of any analysis, it may

[7] *Buckley & Young v CIR* (1978) 3 NZTC 61,271 (CA) at 61,276.

[8] See *CIR v Europa Oil (NZ) Ltd* [1971] 641 at 651 (PC) where the Privy Council considered there was a single interrelated complex of agreements.

not be conclusive. Each transaction must be carefully considered to identify the legal rights and obligations of the parties involved.

The approach to mixed transactions

20. A software transaction may involve multiple classifications or types of transaction (eg, sale, licence, lease or service). Based on the Court of Appeal authority at [22], the Commissioner accepts that if one component is merely ancillary or incidental to another, it should be classified according to that component of the transaction. However, if there are distinct components that are not ancillary or incidental, each should be treated as a separate transaction. This may require splitting (apportioning) payments, as discussed further from [24].

21. In the Commissioner's view, the ordinary meanings of "ancillary" and "incidental" suggest that one component of a transaction would be ancillary or incidental to another where it:

- is relatively minor, small or inconsequential;
- does not service any independent purpose but naturally attaches to or follows on as a consequence of something else; or
- is additional to, but less important or subsidiary.

22. The Court of Appeal decision in *Buckley & Young* supports this approach. As Richardson J stated:[9]

> Difficulties of characterisation may arise where the director or employee agrees to resign and to give a restrictive covenant. **The proper conclusion may be that the payment secures one advantage and the other provision is merely ancillary or incidental, not affecting the character of the payment** (cf. *Anglo-Persian Oil Company Limited v. Dale (H.M. Inspector of Taxes)* [1932] 1 K.B. 124, 139- 140). **In other cases distinct and separately identifiable advantages may be gained by the payment.** There the payment is of a dual character. The statement of the problem highlights the importance of identifying the true character of the payment for which deduction is sought.
>
> [Emphasis added]

23. For example, a developer might buy a software development tool for a one-off fee to create other software, which includes the right to use libraries of reusable code in the products they develop. If the right to distribute these libraries is ancillary or incidental to the supply of the development tool, the entire transaction is treated solely as the supply of a copyrighted article.

[9] At 61,275.

Apportionment

24. As mentioned at [20], mixed transactions may include distinct components that must be classified and treated as separate transactions. In such cases, the total payment may need to be apportioned among the individual components.

25. The OECD Model commentary on art 12 (Royalties) discusses apportionment in the context of software as follows:

> 17. Software payments may be made under mixed contracts. Examples of such contracts include sales of computer hardware with built-in software and concessions of the right to use software combined with the provision of services. … Where necessary the total amount of the consideration payable under a contract should be broken down on the basis of the information contained in the contract or by means of a reasonable apportionment with the appropriate tax treatment being applied to each apportioned part.

26. The contractual arrangements between the parties is the starting point for considering apportionment issues. To safeguard their interests, parties should address these issues when negotiating and drafting the terms of a transaction. However, apportionment needs to be made on a reasonable and proper basis. Apportionment may be required for any software transaction that is a mixed transaction.

27. Courts have, at times, gone behind the parties' agreement and reallocated consideration on a different basis, particularly where the contractual arrangements are silent on such matters.[10] However, as the High Court of Australia confirmed in *PepsiCo*, an objective characterisation and construction of the parties' agreements is critical—especially where intellectual property is involved and there is no express provision for royalty payments.[11] The decision reinforces the transactional approach outlined from [14].

The software transactions are cross-border transactions

28. This guideline addresses software transactions where New Zealand residents make payments to non-residents. These payments raise specific tax implications because of their cross-border nature. Regardless of the classification, such transactions share common tax considerations, including:

- whether the income has a New Zealand source for the non-resident;

[10] See *CIR v Europa Oil (NZ) Ltd* (PC) at 649–651; *Peterson v CIR* (2005) 22 NZTC 19,098 (PC) at [51]; *Henwood v CIR* (1995) 17 NZTC 12,271 (CA).

[11] *FCT v PepsiCo* [2025] HCA 30 at [159].

- which withholding tax regime (if any) applies;
- what investment income information must be reported to Inland Revenue;
- how DTAs may affect the tax treatment; and
- the transfer pricing implications for associated-party transactions.

New Zealand–sourced income of non-residents

29. Non-residents are taxed on income that has a New Zealand source. Section YD 4 specifies the types of income considered to have a New Zealand source, including:
    - income from a business wholly or partly carried on in New Zealand (s YD 4(2));
    - income from contracts made or performed in New Zealand (s YD 4(3));
    - income from the use in New Zealand of personal property (s YD 4(8));
    - royalties (s YD 4(9)); and
    - interest (s YD 4(11)).[12]
30. These rules apply only to income, not capital transactions (eg, selling copyright rights in software outright when such sales are not part of a business or income-earning activity of making such sales).
31. Not all of the types of New Zealand–sourced income listed in s YD 4 are relevant to every software transaction. However, business income and income from contracts are likely to be relevant to most transactions.

Business income (s YD 4(2))

32. If a non-resident carries on their business entirely in New Zealand, all business income has a New Zealand source. If they carry out only part of the business in New Zealand, only the income from the New Zealand part has a New Zealand source and must be apportioned under s YD 5. The apportionment must reflect the outcome as if a separate and independent person were carrying on the activity and dealing at arm's length in New Zealand (s YD 5(3)). However, s YD 5 does not apply to business activities carried out through a permanent establishment (see [66]).
33. Whether a non-resident is carrying on a business in New Zealand depends on the facts of each case. Courts look at whether someone is trading **with** a country or trading

[12] In this guideline, interest income with a New Zealand source is only expected to arise in software transactions that involve a finance lease of a copyrighted article (see [169]).

within that country.[13] Factors that may indicate a non-resident is carrying on business within New Zealand include that they are:

- manufacturing or producing items in New Zealand for profit;
- selling goods or services in New Zealand, including through an agent or employee – even if the contract or the transaction is completed outside New Zealand;
- regularly entering into contracts in New Zealand or having someone do this on their behalf – especially if goods are delivered and paid for in New Zealand; or
- holding stock in New Zealand to fulfil orders directly or through an agent.

34. While these factors reflect traditional "bricks and mortar" business models, they remain relevant in a digital environment. Additional considerations may include the location of web sites and their level of interactivity (eg, for processing orders or concluding contracts), as well as the location of virtual offices, servers, internet service providers and other related infrastructure.[14]

Contract income (s YD 4(3))

35. Income from a contract has a New Zealand source if the contract is made or performed in New Zealand. The exception is where the non-resident wholly or partly performs the contract outside New Zealand. In the latter case, all or part of the income may be allocated to a source outside New Zealand (s YD 5).

36. If the contract is made outside New Zealand but the non-resident performs some or all of the contract in New Zealand, then part of the income is allocated to a New Zealand source (s YD 5).

37. To determine the source of the income, consider:

- **where the contract was made**, which can depend on factors such as the contract's language and currency, the location of the parties and their business operations and where disputes are resolved; and
- **where the contract is performed** – that is, where the obligations under the contract are actually carried out.

[13] See, for example, Grainger *& Son v Gough (Surveyor of Taxes)* 3 TC 462 (HL) per Lord Herschell at 467.

[14] There is an overlap between this question and the question of whether a non-resident has a permanent establishment in New Zealand – see from [66].

38. Sometimes the contract rule and the business income rule overlap, particularly when contracts form part of a wider business activity. In these cases, income may have a New Zealand source under more than one rule.[15]

Use in New Zealand of personal property (s YD 4(8))

39. Income from the use of, or the right to use, any personal property in New Zealand is treated as having a New Zealand source if the payment is made by:

- a New Zealand resident; or
- a non-resident who is entitled to claim a deduction for the payment.

40. For this rule to apply the property must be:

- personal property;
- located in New Zealand; and
- used or available for use while in New Zealand.

41. The Commissioner considers that payments to non-residents may give rise to New Zealand–sourced income for certain software transactions discussed in this guideline, such as a supply of cloud computing services or the leasing of copyrighted articles.

Royalties (s YD 4(9))

42. Royalties are treated as having a New Zealand source if they are paid by:

- a New Zealand resident and not made in connection with a business they carry on outside New Zealand through a fixed establishment outside New Zealand; or
- a non-resident who is entitled to claim a deduction for the payment.

43. The meaning of "royalties" is broadly defined in s CC 9. Relevantly for software transactions, royalties under s CC 9(2) include payments of any kind derived as consideration for:

> (a) the use of, or right to use, a copyright, patent, plant variety rights, trademark, design or model, plan, secret formula or process, or other similar property or right;
>
> …

[15] See *Tillard v C of T* [1938] NZLR 795 (SC) at 801–802; *Case E46* (1982) 5 NZTC 59,277 (NZTRA) at 59,280; *Case H6* (1986) 8 NZTC 147 (NZTRA) at 152–153.

> (f) the supply of scientific, technical, industrial, or commercial knowledge or information:
>
> …
>
> (h) the supply of assistance that enables the application or use of the above (that is, anything in any of paragraphs (a) to (f)):

44. Payments must be made as "consideration for" these matters. In *PepsiCo*, the majority of the court interpreted this phrase within the Australian definition of "royalty", noting it encompassed a broader range of circumstances than in modern contractual usage. They held that the term refers to the "purpose", "moving cause" or "material cause" of the payment.[16]

45. Under s CC 9(3), none of the following are relevant as regards to whether a royalty arises under s CC 9(2):

> (a) how the payment is described or computed:
>
> (b) whether the payment is periodic or otherwise:
>
> (c) whether the payment is an instalment of the purchase price of real property:
>
> (d) whether the payment is an instalment of the purchase price of personal property.

46. However, despite s CC 9(3), the payment still has to fall within one of the paragraphs of s CC 9(2). For instance, even if paid in instalments, a payment for the purchase of copyright rights would not be a payment for the use of those rights within the meaning of s CC 9(2)(a).

Payments for the supply of assistance

47. As set out at [43], para (h) of the definition of a royalty in s CC 9(2) includes payments for the supply of assistance that enables the payer to apply or use anything that itself gives rise to a royalty. For example, payments for services that help the payer to apply or use a right to use the copyright in software will also be a royalty because the right to use copyright gives rise to a royalty under para (a) of the definition. Another example is payments for the provision of training or any other services that help the payer to apply or use know-how (payments for which are royalties under para (f)).[17]

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[16] At [160].

[17] See also Example | Tauira 21 Supply of other services – para (h) of s CC 9 (Royalties).

48. An example where a royalty would not arise under para (h) is a helpdesk service provided to assist users of software with technical issues related to the operation of the software that has been provided as a copyrighted article, (ie, a copy of the software). The supply of a copyrighted article does not give rise to a royalty. On this basis, payments for helpdesk services in relation to a copyrighted article will not give rise to a royalty.

Withholding tax regimes applicable to the income of non-residents

49. To ensure tax is collected on New Zealand–sourced income derived by non-residents, withholding tax obligations may be imposed on the New Zealand resident making the payment. For software transactions, the following regimes may apply:

- non-resident withholding tax (NRWT); or
- non-resident contractor schedular payments (NRCT).

Non-resident withholding tax

50. If a person pays non-resident passive income – such as New Zealand–sourced royalties or interest – they are generally required to withhold tax from the payment and pay it to the Commissioner.[18] The standard NRWT rate for royalties or interest is 15%.[19]

51. For the non-resident, NRWT can be either:

- **A final tax** – for example, when interest is paid to an unassociated person or when payments are zero-rated for NRWT (ie, payments liable to approved issuer levy)[20].
- **A minimum tax** – for example, when royalties are paid for the supply of know-how.

52. NRWT does not apply to interest payments where the non-resident has a "fixed establishment" in New Zealand.[21] Also, royalties do not have a New Zealand source under s YD 4(9) if they are paid by a New Zealand resident in respect of a business they carry on outside New Zealand through an overseas fixed establishment.

[18] See ss RA 6(2), RF 2 and RF 3(1).

[19] Section RF 7(2).

[20] Approved issuer levy (AIL) is tax mechanism that may be a more favourable alternative to NRWT on interest payments made to non-residents.

[21] See s RF 2(2B)(a). Resident withholding tax (RWT) may, however, apply. See footnote 12, interest may only arise in the current context where there is a finance lease.

53. A fixed establishment, as defined in the Act, is a fixed place of business in which a person carries on a substantial business. It includes:

- a branch, factory, shop or workshop in which, in each case, substantial business is carried on;
- a mine, oil well, quarry or other place of natural resources subject to exploitation; and
- an agricultural, forestry, or pastoral property.

54. A fixed establishment does not include:

- the use of facilities solely for the purpose of delivering, displaying, or storing goods or merchandise belonging to a business; or
- the maintenance of a fixed place of business solely for the purpose of acquiring goods or merchandise or for collecting information or for advertising for business.

55. A "fixed establishment" is a domestic law concept used in the source rules for interest to distinguish between passive investment income (subject to NRWT) and business income. It overlaps with, but is not the same as, the concept of a "permanent establishment" used in connection with DTAs and business income, which is discussed from [66].

Non-resident contractor schedular payments

56. Sometimes a New Zealand resident must deduct withholding tax from a payment because the recipient is a "non-resident contractor" (referred to in this guideline as non-resident contractors' withholding tax or NRCT). This includes a non-resident who undertakes to:

- perform services of any kind in New Zealand; or
- supply the use of, or right to use, in New Zealand any personal property.

57. This withholding tax is required under the PAYE rules as a "schedular payment".[22] Generally, these are payments made under contracts for service (rather than employment contracts).

58. From 1 April 2026, the legislation was clarified by adding an exclusion from NRCT that applies to the provision of software as a service (SaaS), platform as a service (PaaS) or

[22] See s YA 1 "contract activity or service", "contract payment" and "non-resident contractor", s RD 8 and Sch 4 part A.

infrastructure as a service (IaaS).[23] The exclusion does not apply to the extent the service involves personnel located in New Zealand (other than personnel excluded under a DTA and the 92-day rule referred to at [73]). This exclusion is discussed in more detail from [122].

59. A contract for services in a software-related transaction may include situations where the non-resident software supplier agrees to perform services in New Zealand by having personnel physically present in New Zealand. Alternatively, the non-resident software supplier may subcontract all or part of those services to another non-resident who, in turn, sends personnel to New Zealand to carry out the work.

60. In these situations, NRCT may apply to the contract payment that the New Zealand customer makes to the non-resident software supplier. In addition, NRCT may arise on the subcontract payments that the non-resident software supplier makes to the third-party subcontractor, as that subcontractor will also be a non-resident contractor in their own right. However, the subcontractor may not be deriving New Zealand-sourced income and territorial limitations remain relevant. NRCT may not apply unless the non-resident software supplier has brought themselves within the New Zealand taxing jurisdiction by having a sufficient presence in New Zealand.[24]

61. There are, however, some exceptions to when NRCT applies. One exception (in s RD 8(1)(b)(v)) is where there is full relief from tax under a DTA, and personnel are present in New Zealand for 92 or fewer days (see further from [73]). Another exception (in s RD 8(1)(b)(vi)) is where payments are for a non-resident's contract activity or service and total $15,000 or less in a 12-month period. This exception applies to a "contract activity or service" which includes both rendering services in New Zealand and supplying the use of, or the right to use personal property in New Zealand. The $15,000 threshold is measured by aggregating all contract activities the non-resident contractor undertakes in the relevant period.[25,] A Government policy proposal included in Budget 2026 is to modernise the NRCT rules. Proposals include raising the $15,000 threshold to $75,000 to be measured under a "single-payer" view. The single-payer view means New Zealand entities that engage a non-resident contractor only need to consider their own contractual activity with the contractor in a 12-month period.

[23] See Taxation (Annual Rates for 2025-26, Compliance Simplification, and Remedial Measures) Act 2026, s 131(8) amendment to definition of "contract activity or service" for a non-resident contractor.

[24] For analogous reasoning, see OS 21/04: Non-resident employers' obligations to deduct PAYE, FBT and ESCT in cross-border employment situations. See also IS 10/04: Non-resident contractor schedular payments *Tax Information Bulletin* Vol 22, No 7 (August 2010): 29 at Example 3 (which predates and therefore does not discuss the territorial limitation aspect subsequently discussed in OS 21/04).

[25] IS 10/04 at [34].

62. Non-resident contractors must give the payer a tax rate notification (**Tax rate notification for contractors – IR330C**) so the correct tax rate can be withheld.[26] Unless an exemption or another rate applies, the standard rate is 15%. Other rates that may apply include:

- the non-resident's elected rate (15% or greater);
- a rate set by the Commissioner that may apply if the payee has tax arrears;
- a special rate provided by the Commissioner (which may be less than the standard rate); or
- a default rate of 20% for companies or 45% in other cases, which applies where the payer has not been notified of the payee's details.[27]

Investment income information

63. Payers of royalties to non-residents must supply investment income information to the Commissioner in electronic form under subpart 3E of the Tax Administration Act 1994.[28]

64. In broad terms, the information includes the details of the payer and payees (eg, name, tax file number, contact addresses) along with details of the date, amount and type of payments made and total amounts of income tax withheld. The payee must provide this information annually by 31 May after the end of the tax year.

Double tax agreements

65. Subject to certain limitations,[29] DTAs can override or change the standard tax implications for non-residents deriving New Zealand–sourced income and may provide a more favourable tax treatment.

Business profits

66. If a non-resident of New Zealand is a resident of a country that has a DTA with New Zealand, their business income under s YD 4(2) may not be taxable in

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[26] Section 24I of the Tax Administration Act 1994. See [61], the Budget 2026 proposals include creating a tax code for NRCT for use in the PAYE system.

[27] See ss RD 10, RD 10B, sch 4 part A of the Act and Tax Administration Act 1994, ss 24F, 24G, 24H, 24I sch 5 part C.

[28] See Tax Administration Act 1994, ss 25C, 25D, 25E(1)(d), 25H and sch 6 and Payers of royalties to non-residents – reporting requirements (webpage, Inland Revenue, 2021).

[29] See s BH 1, subs (4) and (4B).

New Zealand.[30] This is because, art 7 of most DTAs allocates taxing rights on business profits to the non-resident's home country – unless the non-resident has a permanent establishment (PE) in New Zealand.

67. Article 5 of the OECD Model defines a PE. Determining whether a PE exists in New Zealand can be complex and depends on the specific DTA. If a PE is present, New Zealand can tax the income attributable to it, calculated as if the PE were a separate independent business.

68. For example, and specifically relevant to this guideline's context, locating a computer server in New Zealand may constitute a PE whereas having a web site alone is not enough.[31]

69. Business profits under a DTA can be treated in one of two ways:

- If the profits are attributable to a PE in New Zealand, art 7 takes priority.[32]
- If they include interest or royalties and are not attributable to a PE in New Zealand, art 11 or art 12 applies, allowing for reduced rates of withholding taxes.

Royalties

70. DTAs generally contain their own definition of a "royalty". Most commonly, there is substantial overlap between the DTA definitions and our domestic definition. However, in some cases they can differ in significant ways. For instance, New Zealand's DTAs generally do not feature the aspect of the domestic definition relating to whether a payment is an instalment of the purchase price of real or personal property (see [45]). An important first step, therefore, is to ascertain the domestic tax treatment of a payment that might be a royalty and then consider the relevant DTA definition.

[30] For a list of countries that have a DTA with New Zealand, see Tax treaties (webpage, Inland Revenue, no date). In some cases, these DTAs have been modified by the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (OECD Publishing, Paris, 2016). See also: New Zealand's ratification of the OECD's Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting *Tax Information Bulletin* Vol 30, No 10 (November 2018): 2.

[31] See OECD Model commentary on art 5 "Electronic commerce" at [122] – [131]. See also "Location of web and server sites has few tax implications" (online report, Inland Revenue, 2001).

[32] See the OECD Model commentary art 11(4) and art 12(3).

Withholding taxes

Non-resident withholding tax

71. Under art 11 of the OECD Model, both the country where any interest arises and the non-resident's country may tax the interest. However, New Zealand's tax is generally capped at 10%. As noted from [169], where a software transaction is classified as a finance lease, the Act treats part of the payments arising under it as interest.

72. Article 12 of the OECD Model allocates sole taxing rights on royalties to the non-resident's country of residence. New Zealand does not follow the OECD Model when it comes to royalties and its DTAs provide some taxing rights to the source jurisdiction, usually at a reduced rate of 5 or 10%.[33]

Non-resident contractor schedular payments

73. A "schedular payment" does not include a payment to a non-resident contractor who has full relief from tax under a DTA and is present in New Zealand for 92 or fewer days in a 12-month period.[34] The Commissioner interprets "full relief from tax under a double tax agreement" as applying to each specific contract activity.[35] For this reason, determining whether the services qualify for DTA relief may be a challenging task, as the rule must be applied to each transaction with a New Zealand customer over each 12-month period.

74. DTA relief may also apply where the non-resident contractor earns business income but does not have a PE in New Zealand. In such cases, the Commissioner may grant exemptions from withholding tax.[36]

75. As noted at [56], a schedular payment includes a payment in a situation where a non-resident supplies the use of, or right to use, in New Zealand any personal property. This includes leases of copyrighted articles that may be treated as a royalty under some of New Zealand's DTAs. The tax implications of this are discussed further from [164].

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[33] Article 12 and the reduced rate are limited to an arm's length amount of the royalties if, due to a special relationship between the parties or some other person, the amount of the royalties exceeds the amount that parties would have agreed in the absence of such a relationship (art 12(4)).

[34] Section RD 8(1)(b)(v).

[35] IS 10/04 at [32].

[36] See s RD 24 of the Act and Tax Administration Act 1994, s 24H and sch 5, part C, cl 6. See also Apply for an exemption as a non-resident contractor (webpage, Inland Revenue, 2026).

Transfer pricing rules

76. As cross-border transactions, software transactions could potentially fall within the rules that apply to transfer pricing arrangements in ss GC 6 to GC 14. Transfer pricing rules require cross-border associated party transactions to be conducted on an arm's length basis.

77. The rules must apply consistently with the OECD transfer pricing guidelines used to apply art 9 (Associated Entities) of the OECD Model incorporated into New Zealand's DTAs.[37]

78. The application of the transfer pricing rules is distinct from the transactional analysis approach set out from [14]. An analysis of the transfer pricing rules is outside the scope of this guideline.[38]

Some key characteristics of software

79. When analysing software transactions, it is helpful to understand certain key characteristics of software.

Copyright protection

80. Copyright rights are a property right that applies to original works, including literary works, which includes a computer program.[39] A copyright owner has exclusive rights to do certain acts, including the following that are relevant to software transactions: [40]

    - copying a program;
    - issuing copies to the public (by sale or otherwise);
    - performing the work publicly (eg, for marketing);
    - communicating the work to the public;
    - adapting a program; and
    - authorising others to do any of these acts.

81. Given software is included in copyright rights, there are two kinds of software transactions:

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[37] Section GC 6(1B). See: Organisation for Economic Co-operation and Development, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD Publishing, Paris, 2022).

[38] For more information, see: Transfer pricing (webpage, Inland Revenue, 2021).

[39] Copyright Act 1994, s 14(1)(a), and s 2 definition of "literary work", para (b).

[40] Copyright Act 1994, s 16(1).

- **A copyright rights transaction** involves rights under copyright (eg, a right to make further copies of a software program).
- **A copyrighted article transaction** involves a copy of the original works protected by copyright (a "copyrighted article"), such as a copy of software downloaded over the internet or provided on a disk.

82. Distinguishing between these transactions can be challenging when a person obtains a restricted copyright right. The key question is whether the person can commercially exploit the copyright in the program. If the person only acquires the right to use a copy of the program without the ability to commercially exploit the copyright, the transaction is a copyrighted article transaction.

83. A copyrighted article transaction typically generates business profits. However, if the person acquires the right to exploit the underlying copyright in the article (eg, a right to make additional copies), the transaction generally involves royalties. Copyright is therefore a critical aspect in determining the classification of software transactions.

84. Certain provisions of the Copyright Act 1994 allow acts that would otherwise infringe copyright in software, including:
    - making back-up copies (s 80);
    - decompiling a program (s 80A);
    - copying or adapting a program for its lawful use, including error correction (s 80B); and
    - observing, studying, or testing a computer program (s 80C).

85. Accordingly, a software user may perform certain acts involving copying or use of software without obtaining a copyright licence. Further, s 80D provides that some of these provisions (ss 80A(2) or 80B(1)) may not be excluded or limited by contract.[41]

End-user licensing agreements (EULAs)

86. Usually, it is straightforward to determine whether a software transaction involves copyright rights. However, in some cases this can be difficult. For example, difficulties arise when:
    - restricted copyright rights are obtained; or
    - agreements use terms such as "licence" which imply the involvement of copyright rights but do not clearly grant a licence.

[41] See also *Intellectual Property in New Zealand* (2nd ed, LexisNexis NZ Ltd, Auckland, 2011), Chapter 12 Computer Software at 12.2.1(c).

87. A common example of the latter is the end-user licence agreement (EULA). Historically, customers accepted these agreements by opening the software packaging or installing the software which gave rise to the term "shrink-wrap" licences. Today, where software is often downloaded, EULAs are typically digital and accepted by clicking an "I agree" button (giving rise to the term "click-wrap" licences"). Classification of software transactions, however, depends on the rights and subject matter supplied, rather than the means of distribution.

88. EULAs are generally used in mass-market software distribution, where it is impractical for the copyright owner to negotiate individual licence terms with each user. These agreements typically restrict the user's rights, allowing installation on a single device and prohibiting actions such as redistribution, rental, leasing or sublicensing.

89. Although a EULA is termed a "licence" agreement, this does not mean copyright rights are always obtained. The transactional analysis approach discussed from [14] should be applied to determine the practical and commercial intent of the agreement. Is the consideration paid for a copy of the copyrighted program, or for a licence to exploit the copyright?

90. A reproduction licence allows the licensee to exploit the software copyright by making copies of the software for external distribution. An EULA does not grant this right. In most situations, EULA terms reinforce the copyright owner's rights, rather than permitting exploitation of the copyright, and they often explicitly prohibit such acts.[42] The main function of an EULA is to provide the owner with protection against piracy and unauthorised exploitation of its copyright.

Site, enterprise and network licences

91. A key feature of software is that it is easy to copy. Licensing and distribution arrangements often let customers make multiple copies of the program for internal business use. The following are common arrangements:

- **Site licences** are limited to one physical location. All users, or a capped number of users, at a site can use the software without individual licences.
- **Enterprise licences** cover the entire organisation regardless of location or number of users. All employees across different sites and countries can use the software.

[42] See for example, the Supreme Court of India decision *Engineering Analysis Centre of Excellence Private Ltd v The Commissioner of Income Tax* 2021 INSC 137. The court concluded the EULAs in that case did not grant any right or interest in copyright (at [47] and [168]).

- **Network licences** allow multiple users access to the same software at the same time over a network.

92. Where a group company licensee chooses to recover its costs plus a margin from other group members through internal charges, that fact does not change the classification of the transaction between the licensee and the software supplier. It does not mean the supplier has provided the licensee any right to commercially exploit its copyright. The licensee is able to charge group members internally due to the group relationship, rather than because of the licence agreement with the supplier.

93. Other licensing arrangements may also permit the licensee to make multiple copies of the software. However, these reproduction rights are typically limited to what is necessary for the program to operate on the customer's computers or network. Copying for any other purpose is prohibited. The key point is that the right to copy is restricted – customers cannot commercially exploit the supplier's copyright.

94. From an income tax perspective, the copying rights are incidental or ancillary aspects of the arrangement that enable the intended end-use of the software and, should be disregarded when classifying the transaction. For example, if a customer receives a site licence allowing them to install 50 copies of a program for employees at one location, this is treated as the purchase of 50 individual copyrighted articles. If the right to use the program is permanent, the transaction is classified as the sale of copyrighted articles.

Market intermediaries – distributors and resellers

95. Software transactions often involve distributors or resellers. These are New Zealand–based market intermediaries who facilitate the movement of software from copyright owners to end-users.[43] Considering the role of distributors is important because their involvement means the cross-border aspect of the transaction can arise from or include the arrangements the non-resident has with the distributor, rather than with end-users.

96. In the past, the main role of distributors was to purchase copyrighted articles and resell them. Although agreements between such distributors and copyright owners may be labelled a "licence", typically such distributors have not obtained the right to commercially exploit the relevant program's copyright.

[43] There are also overseas-based market intermediaries that act as platforms or marketplaces for selling software applications (eg. "app stores"). These intermediaries are not being discussed here. Depending on the circumstances, New Zealand customers dealing with such non-residents may often be acquiring a copyrighted article (see discussion from [150]).

97. If such distributors obtain any copyright rights (except the reproduction right) solely to enable the distribution of the copyrighted articles, those rights are considered ancillary and incidental. For classification purposes, these rights can be disregarded when determining the character of transactions between distributors and non-resident software providers.[44] The transactions involve the on-selling of copyrighted articles and do not give rise to royalties.

98. With the rise of cloud computing, distributors' roles have evolved and they are usually referred to as "resellers" in this context. Some resellers purely buy and resell access to the use of software and provide no other customer services. Other resellers may provide additional customer services (as value-added resellers – see below from [102]). In either form, resellers generally do not obtain copyright rights to reproduce the software.

99. If purely on-selling access, resellers may obtain incidental or ancillary copyright or other rights in a similar way to distributors of copyrighted articles. For instance, the reseller may need to use the cloud computing provider's name, product names, logos and other brand identifiers in order to market the provider's products. For classification purposes, these incidental or ancillary rights can be disregarded. Accordingly, unless additional rights are conferred, a transaction between a non-resident cloud computing provider and a New Zealand resident reseller simply on-selling access is classified on the same basis as those involving the distribution of copyrighted articles. That is, they typically do not give rise to royalties.

100. This is because these basic resellers pay non-resident cloud computing providers for the right to distribute the software to end-users. They typically do not pay the non-resident provider for the use of, or right to use, the copyright in the software, and they do not obtain know-how, or receive rights to use other intellectual property. This may not be the case for value-added resellers, however, as discussed below.

101. Regardless of whether resellers are purely on-selling access or are providing additional customer services, the typical payment flows are similar to those arising for distributors of copyrighted articles. The customer is invoiced by, and pays, the reseller in New Zealand dollars and the reseller pays the non-resident cloud computing services provider, often net of a margin. In these circumstances, the relevant cross-border payments to which this guideline applies are the payments that the reseller makes.[45]

[44] This is consistent with the international approach: see OECD Model commentary on art 12 at [14.4].

[45] Multi-tiered arrangements are possible where resellers deal with other resellers rather than end-users. However, no additional outgoing cross-border payments within the scope of this guideline are likely to arise in that case.

Value-added resellers

102. As mentioned, some resellers, may provide customer services that are additional to simply on-selling access to the cloud computing services. Depending on the circumstances and the additional customer services provided, these resellers are known by a range of terms, such as value-added reseller, cloud solution provider, managed service provider, systems integrator and global systems integrator. For the purposes of this guideline, we refer to these types of resellers collectively as value-added resellers (VARs).

103. The additional customer services that VARs provide may include:

- consulting and advisory support;
- implementation and data migration assistance;
- systems integration, customisation or configuration;
- user training and onboarding;
- ongoing technical support and day-to-day managed services;
- consolidated billing and licence management; and
- security or compliance guidance.

104. Customers will determine the extent of additional services (if any) they wish to receive in each case.[46] Hence, these services may be separately negotiated and contracted for and may be performed by different personnel. However, the VAR's arrangements with its domestic customer are not generally relevant to its arrangement with the non-resident cloud computing provider, except where they indicate that the cross-border arrangement differs from what would otherwise be the case.

105. The presence of additional customer services alone may not mean the treatment of VARs differs from basic resellers in terms of the characterisation of their cross-border arrangements. The reseller may be able to provide these additional customer services by drawing on their own expertise, skills and knowledge. However, it is also possible that in order to provide some of these additional customer services, the VAR needs to obtain copyright rights in the cloud computing provider's software which they would not need to do if they were simply on-selling access. Additionally, or alternatively, the VAR may, in some cases, need to obtain other rights to use intellectual property or

[46] Customers may, instead, obtain these services elsewhere, including from non-residents, in which case they may make payments falling within the "development, modification or other services" transaction type (see from [185] and Example | Tauira 22 (Supply of other services – cloud computing arrangement)).

confidential information (ie, know-how) from the provider. These rights may fall within the definition of a royalty in s CC 9 or a relevant DTA.

106. The result may be that the arrangement is classified as a mixed transaction. In these circumstances, it is also possible that, unlike the situation with a basic reseller, these other rights may not be an incidental or ancillary part of the arrangement with the non-resident cloud computing provider. Consequently, apportionment of the payments between the VAR and the non-resident provider may be required (see discussion from [20] and [24] and Example | Tauira 4).

107. It will be necessary to carefully evaluate the entire arrangement between the non-resident provider and the VAR on a case-by-case basis to establish the appropriate characterisation of the entire arrangement or parts within it.

Integrated software

108. Software is increasingly included in, or integrated into, tangible goods. The software may be obtained by the original equipment manufacturer from other companies. The classification of a transaction involving integrated software in this sense depends on whether or not it includes any rights in the software. It follows that, therefore, the same principles in this guideline regarding software more generally can apply.

109. This approach includes where the integrated software is considered a copyrighted article (see [154]) or has a cloud computing element and involves a reseller (see from [120]). A special case of integrated software arises if the tangible good is an item of industrial, commercial or scientific equipment (see from [164]).

Classification of software transactions

110. This guideline covers common software transactions and their tax implications, including:

- supplies of cloud computing services;
- sales of copyright rights;
- licensing of copyright rights;
- sales of copyrighted articles;[47]
- leasing of copyrighted articles;
- supplies of know-how;

[47] See footnote 2.

- supplies of development, modification or other services.

111. Where relevant, this guideline also considers these transactions when they involve a market intermediary.

112. As mentioned at [14], this guideline focuses on payments made to non-residents. Readers should keep this focus in mind throughout the following discussion, as the relevant outgoing cross-border payments will vary depending on the arrangement.

Supply of cloud computing services

Discussion

113. A cloud computing transaction is a common scenario where a non-resident software supplier may receive payments from New Zealand. The United States National Institute of Standards and Technology (NIST) defines "cloud computing" in this way: [48]

> Cloud computing is a model for enabling ubiquitous, convenient, on-demand network access to a shared pool of configurable computing resources (e.g., networks, servers, storage, applications, and services) that can be rapidly provisioned and released with minimal management effort or service provider interaction. This cloud model is composed of five essential characteristics, three service models, and four deployment models.

114. This definition refers to three cloud service models:

- software as a service (SaaS);
- platform as a service (PaaS); and
- infrastructure as a service (IaaS).

115. The common feature of these models is that the customer does not manage or control the underlying cloud infrastructure, including the network and servers. Both the risk with and control over the infrastructure remain with the cloud computing provider.

116. Customers may have different levels of control over operating systems, applications and storage, depending on the service model. For example, within its definition above, NIST further explains SaaS arrangements as follows:

> *Software as a Service (SaaS).* The capability provided to the consumer is to use the provider's applications running on a cloud infrastructure. The applications are accessible from various client devices through either a thin client interface, such as a web browser

[48] National Institute of Standards and Technology, Department of Commerce (US), *The NIST Definition of Cloud Computing: Recommendations of the National Institute of Standards and Technology* (Computer Security Division, NIST, Gaithersburg, 2011) at 2.

(e.g., web-based email), or a program interface. The consumer does not manage or control the underlying cloud infrastructure including network, servers, operating systems, storage, or even individual application capabilities, with the possible exception of limited user-specific application configuration settings.

117. Under the other service models, the customer may gain control over applications (PaaS) or, additionally, control over operating systems and storage (IaaS).

118. Payments to a non-resident under a cloud computing transaction may be made:

- directly from the non-resident's New Zealand customers;
- from a New Zealand distributor or reseller of the non-resident's cloud computing services;
- from a New Zealand entity that has obtained the right from a non-resident copyright owner to be the provider of cloud computing services to New Zealand customers (ie, rather than reselling those services); or
- from a New Zealand entity that is providing services to customers of a non-resident cloud computing services provider, similar to those provided by some value-added resellers, but is not a reseller or distributor.

119. The classification of these transaction types will depend on the contractual arrangements:

- **Payments directly from New Zealand customers:** These transactions typically do not involve transferring a copyright right or a copyrighted article to the customer. The Commissioner generally considers these transactions are classified as involving the provision of a service. Specifically, they involve supplying on-demand access to computer resources remotely from outside of New Zealand.
- **Payments from a reseller:** Where a reseller is involved, the classification remains as a service transaction if it involves the service of simply reselling access to the cloud services. However, as noted at [102], some resellers may provide additional customer services, such as consulting and advisory support, implementation and data migration, systems integration, customisation and configuration, training, technical support, billing, licence, security management or guidance. It is possible that, in such cases, the reseller (a VAR) may need to obtain copyright rights in the cloud software or other intellectual property rights or know-how from the non-resident to place it in a position to provide these additional customer services. These rights might give rise to royalties. If they are not an incidental or ancillary part of the arrangement, the transaction may constitute a mixed transaction. Payments between the reseller and non-resident

may be classified as involving both services and royalties, and apportionment may be required.[49]

- **Payments from a New Zealand cloud computing provider**: If the provider of the cloud computing services to customers is based in New Zealand and is not the copyright owner, the type of transaction that arises between the provider and the copyright owner is different from a transaction involving a distributor or reseller. Given that the New Zealand entity's commercial exploitation of the software is the object of these transactions, such arrangements may involve the non-ancillary or non-incidental provision of copyright rights to the New Zealand entity. This may result in a royalty classification of the payments to the non-resident copyright owner.[50] These payments may also be considered to be payments for the use of, or right to use, personal property (ie, the cloud computing software) in New Zealand.
- **Payments from a New Zealand provider of services to customers of a non-resident cloud computing services provider where it is not a distributor or reseller:** This is a similar situation to that referred to at [102] where the New Zealand entity is a VAR providing additional customer services. However, in this instance, the New Zealand entity is not also a reseller.

Tax implications

Payments directly from New Zealand customers and from New Zealand resellers (not VARs)

New Zealand–sourced income

120. Payments from customers and distributors in the first two situations referred to at [118] are generally classified as a supply of services that do not give rise to royalties. These payments are not likely to be taxable to the non-resident software supplier unless they have a New Zealand source under s YD 4. In the context of software transactions, payments may potentially have a New Zealand source, and so be taxable income, if they are derived from any of the following:

- A business carried out wholly or partly in New Zealand (s YD 4(2)).
- A contract made or performed in New Zealand (s YD 4(3)).

[49] If the New Zealand end-user paid a non-resident for these value-added services independent of any arrangement with a reseller, the transaction would need to be classified separately according to this guideline.

[50] This is consistent with the view of the Internal Revenue Service, Department of the Treasury (US) under "E. Copyright rights related to digital content used for cloud transactions".

- In the case of New Zealand customers dealing directly with the non-resident cloud computing provider, the use of personal property in New Zealand (s YD 4(8)) if the cloud computing hardware or software is located in New Zealand (excluding incidental or ancillary access software downloaded onto a New Zealand customer's device). This conclusion is unaffected by whether the software is hosted on infrastructure owned or leased by the non-resident. What matters is the location of the personal property used by the customer, including both the application software and the supporting infrastructure software.

121. However, taxation may not arise if a DTA applies and the non-resident does not have a PE in New Zealand (see discussion from [28]).

Non-resident contractor schedular payments

122. As mentioned, where the cloud computing hardware or software is located in New Zealand, non-resident contractor schedular payments and a withholding tax obligation (NRCT) may potentially arise. This is because the payments could be seen as being made to a non-resident for them to provide to end-users the use of, or right to use, in New Zealand, personal property (see [56]).

123. However, as mentioned at [58], from 1 April 2026 non-resident contractor schedular payments do not include the provision of SaaS, PaaS or IaaS except to the extent the transaction involves personnel in New Zealand (other than personnel excluded under a DTA and the 92-day rule in s RD 8(1)(b)(v)). This clarification means that NRCT will not apply simply because a non-resident cloud computing provider might, in the absence of this exclusion, be considered to be rendering a service, or providing the use of, or right to use personal property in New Zealand under the Act's definition of a "non-resident contractor".

124. NRCT applies, however, to the extent these transactions involve non-excluded personnel in New Zealand. Typically, it should be relatively straightforward to determine whether personnel in New Zealand are involved in the transaction.

125. In addition, the exclusion in s RD 8(1)(b)(vi) can apply if the payments are for a non-resident's contract activity or service and total $15,000 or less in a 12-month period.[51] This exclusion applies to a "contract activity or service". It includes both rendering services in New Zealand and providing the use of, or right to use, in New Zealand, personal property. Therefore, where the exclusion applying from 1 April 2026 does not apply because personnel in New Zealand are involved, this rule could still exclude payments from the NRCT.

[51] See [61] regarding proposals to increase this threshold.

Payments from New Zealand value-added resellers

126. As discussed from [102], royalties could potentially arise where the reseller provides additional customer services and doing so requires the reseller to obtain copyright rights or rights to use other intellectual property or know-how.

127. If these additional rights are not an incidental or ancillary part of the arrangement between the VAR and the non-resident cloud computing provider, the transaction may constitute a mixed transaction involving services and the licensing of copyright in software or other intellectual property or the supply of know-how. In such cases, an appropriate apportionment of any payments is required. As mentioned, each case will need to be assessed on its own facts.

128. For any royalty component, the payments will have a New Zealand source under s YD 4(9). The payments may also have a New Zealand source as income from a business (s YD 4(2)) or as income derived from a contract made or performed in New Zealand (s YD 4(3)). However, taxation in New Zealand on business income may not arise if a DTA applies and the non-resident does not have a PE in New Zealand (see the discussion on the cross-border aspects of software transactions from [28]).

129. As noted at [50], royalties that a non-resident derives from a New Zealand source are subject to NRWT at a rate of 15% on the gross payments. However, the royalties article of an applicable DTA will generally reduce the NRWT rate to 5% or 10%, unless the royalty is attributable to a PE (in which case the full rate would apply).

Non-resident contractor schedular payments

130. In this situation, where the reseller is a VAR, a question may arise as to whether NRCT applies because the non-resident copyright owner is providing the use of, or right to use, in New Zealand, personal property (ie, the software or other intellectual property or know-how). However, the reseller is not generally paying the non-resident for the right to use the software, but for the right to resell access to use it. Also, NRCT does not arise to the extent there are royalties because the definition of a "contract payment" in s YA 1 (for NRCT purposes) expressly excludes royalties.

Reporting investment income information

131. Payers of royalties to non-residents are required to supply investment income information to the Commissioner (see [63]).

Payments from a New Zealand cloud computing provider

132. Where the cloud computing provider is located in New Zealand and the non-resident is the copyright owner, payments between the provider and copyright owner may constitute royalties for the right to use certain copyright rights. The tax implications

for these royalties are the same as those outlined above for the royalty component of any reseller payments.

133. If the royalties classification does not apply, payments may be considered as being for the use of, or right to use, in New Zealand, personal property (ie, the cloud computing software) and attract NRCT.

Payments from a New Zealand provider of services to customers of a non-resident cloud computing services provider (that is not also a reseller)

134. Similar tax implications arise where a New Zealand entity is providing the additional customer services mentioned in the discussion of VARs (from [126]) but is not themselves a reseller. That is, there may be royalty implications if the entity obtains rights in copyright, other intellectual property rights or know-how from a non-resident in order to provide the customer services.

Examples | Tauira 1–6: Supply of cloud computing services

Example | Tauira 1: SaaS arrangement with New Zealand customer

Scenario

NZ Co enters into an agreement with Foreign Co to obtain access to a suite of cloud-based business software applications (including document and spreadsheet tools; communication platforms; and enterprise, project and customer relationship management tools).

The agreement is for providing SaaS where the software is hosted on servers at overseas facilities that Foreign Co owns and shares with other Foreign Co customers.

NZ Co cannot modify the software but can configure and customise certain features for its business needs.

User management and limited offline capabilities are enabled through a separate piece of software (service hub software) downloaded from Foreign Co's overseas server.

NZ Co's users can save files online on Foreign Co's server or offline on their own devices, with the service hub software handling synchronisation.

NZ Co pays Foreign Co a monthly fee. Access is limited to 100 users, but this number can be increased for additional fees.

The arrangement can be terminated by either party for default or by NZ Co with 30 days' notice.

Classification

NZ Co receives on-demand access to the use of software but no rights to exploit the copyright in the software. The supply of the service hub software constitutes the right to use Foreign Co's property at the customer's location, but this is incidental and ancillary to the provision of the access to the use of the software.

Overall, the arrangement is classified as the provision of cloud computing services and a supply of services.

Potential tax implications

Payments to Foreign Co are taxable in New Zealand if they have a New Zealand source (eg, income from a business carried on in New Zealand under s YD 4(2), a contract made or performed in New Zealand under s YD 4(3) or for the use of personal property under s YD 4(8)).

If a DTA applies, the income is not taxable unless the payments are attributable to a PE that Foreign Co has in New Zealand.

NRCT does not apply because the transaction involves providing SaaS and does not involve the use of non-excluded personnel in New Zealand.

Example | Tauira 2: SaaS arrangement – reseller <u>not</u> a VAR

Scenario

Foreign Co owns the copyright to several software programs hosted on its own servers that are used to provide cloud computing services. Foreign Co enters into a reseller agreement with NZ Co. Key terms are that:

- NZ Co is appointed as a non-exclusive reseller of Foreign Co's software in New Zealand;
- Foreign Co retains all copyright rights in the software programs;
- NZ Co can market, promote and on-sell Foreign Co's services to end-users in New Zealand; and
- NZ Co pays Foreign Co a "royalty-free" fee calculated to provide NZ Co with a specified margin on the services it on-sells.

Before gaining access to the software, end-users must enter into an EULA with NZ Co which gives customers a limited right to access and use the software. The EULA explicitly provides that customers receive no rights to exploit the software independently of the arrangement supplying access. NZ Co invoices and collects payments from end-users. It pays Foreign Co the same amount less its fee.

Classification

NZ Co does not obtain a copyright right to reproduce the software for its own commercial exploitation. While it enters into EULAs with end-users, these agreements do not license any copyright or other intellectual property rights but instead reinforce their absence.

NZ Co's marketing and promotion obligations and its role in making the software available to end-users, may suggest it has obtained some copyright rights to perform or communicate the software. However, these rights are not ones that allow NZ Co to commercially exploit the software in its own right through copying. NZ Co is not providing the SaaS service itself. Rather, it is simply reselling access to Foreign Co's SaaS service. Any copyright rights or any rights to other intellectual property of Foreign Co (for marketing or promotion purposes) are an incident of, or ancillary to, the reseller arrangement.

Accordingly, the arrangement between NZ Co and Foreign Co is classified as a service.

Potential tax implications

Payments from NZ Co to Foreign Co are taxable in New Zealand if they have a New Zealand source (eg, income from a business carried on in New Zealand under s YD 4(2), or a contract made or performed in New Zealand under s YD 4(3) or for the use of personal property in New Zealand under YD 4(8)).

If a DTA applies, Foreign Co's income is not taxable in New Zealand unless it is attributable to a PE that Foreign Co has in New Zealand.

NRCT does not apply because the transaction involves the provision of SaaS and does not involve the use of non-excluded personnel in New Zealand.

Example | Tauira 3: SaaS arrangement – reseller providing additional customer services (VAR) – no apportionment

Scenario

The facts are largely the same as those in Example | Tauira 2. The key difference is that NZ Co is a VAR. Its additional customer services include:

- consulting and advisory services;
- implementation and data migration; and
- user training developed by NZ Co.

NZ Co provides the additional customer services by drawing on its own expertise, skills and knowledge. The reseller agreement with Foreign Co is unaltered from that in Example | Tauira 2

Classification

In this variation of the facts, NZ Co obtains no additional copyright rights or the use of other intellectual property than that arising in Example | Tauira 2 where any such rights are only incidental or ancillary to the reseller arrangement.

Accordingly, the arrangement between NZ Co and Foreign Co is classified as a service.

Potential tax implications

The potential tax implications are the same as Example | Tauira 2. These are:

- Payments from NZ Co to Foreign Co are taxable in New Zealand if they have a New Zealand source (eg, from a business carried on in New Zealand under s YD 4(2), or a contract made or performed in New Zealand under s YD 4(3) or for the use of personal property in New Zealand under s YD 4(8)).
- If a DTA applies, Foreign Co's income is not taxable in New Zealand unless it is attributable to a PE that Foreign Co has in New Zealand.
- NRCT does not apply because the transaction involves the provision of SaaS and does not involve the use of non-excluded personnel in New Zealand.

Example | Tauira 4: SaaS reseller arrangement – reseller providing additional customer services (VAR) – apportionment

Scenario

The facts are largely the same as those in Example | Tauira 2. The key difference is that NZ Co is a VAR. Its additional customer services include:

- consulting and advisory services;
- implementation and data migration assistance;
- systems integration customisation or configuration, including where necessary modifying or adapting the SaaS software to the customer's specifications; and
- providing access though its website to training materials that Foreign Co has created.

The reseller agreement with Foreign Co is altered accordingly:

- NZ Co is granted the right to adapt the program and retain copyright in any adaptations.
- NZ Co is granted access to Foreign Co's know-how, which consists of the ideas and principles underlying the program, such as logic, algorithms, programming languages and techniques necessary for making adaptations. This information is confidential and NZ Co cannot disclose it without Foreign Co's consent.
- NZ Co is granted rights to exploit Foreign Co's intellectual property in the training materials.
- NZ Co pays Foreign Co a higher fee than the one it charges in Example | Tauira 2 (ie, in consideration for the adaptation rights, access to the know-how and other intellectual property).

Classification

In this variation of the facts, NZ Co obtains additional copyright rights and the use of other intellectual property including know-how. These rights are not ancillary or incidental to other elements of the arrangement between Foreign Co and NZ Co.

Accordingly, the arrangement between NZ Co and Foreign Co is classified as a mixed transaction. That is, it combines elements of a service with those of a licence to use copyright and other intellectual property and a supply of know-how.

The consideration between NZ Co and Foreign Co must be apportioned on a reasonable basis to reflect the arrangement's mixed nature. The uplift on the basic fee that would otherwise apply may provide a basis for apportionment.

Potential tax implications

Payments from NZ Co to Foreign Co are taxable in New Zealand if they have a New Zealand source (eg, from a business carried on in New Zealand under s YD 4(2), a contract made or performed in New Zealand under s YD 4(3), for the use of personal property in New Zealand under s YD 4(8) or for royalties under s YD 4(9)).

If a DTA applies, Foreign Co's income is not taxable in New Zealand unless it is attributable to a PE it has in New Zealand.

The portion of the payments relating to copyright rights or the use of other intellectual properties, is treated as a royalty.

NRWT applies to the royalty portion of the transaction at 15%. The only exception is where a reduced rate applies under a DTA and Foreign Co has no PE in New Zealand to which the property giving rise to the royalties is effectively connected.

NRCT does not apply because the transaction involves providing SaaS and does not involve using non-excluded personnel in New Zealand. Also, NRCT does not apply to the extent that the arrangement involves royalties.

Example | Tauira 5: – Supply of computing infrastructure (IaaS)

Scenario

Foreign Co owns and operates data centres at various overseas locations. It provides NZ Co with computing capacity on Foreign Co's servers in exchange for a monthly fee, calculated based on the amount of computing power allocated to NZ Co. The capability Foreign Co provides includes processing, storage, network, security and other fundamental computing resources. NZ Co provides its own application software.

Classification

Foreign Co's provision of on-demand network computing capacity to NZ Co is a cloud computing transaction. It is classified as the provision of a service.

Potential tax implications

The potential tax implications are the same as Example | Tauira 1. These include, that NRCT does not apply because the transaction involves providing IaaS and does not involve using non-excluded personnel in New Zealand.

Variation – designated server on customer's premises

The facts are the same as above except that, to provide enhanced security for NZ Co, Foreign Co installs a designated server at NZ Co's premises. The server is owned and operated by Foreign Co.

Foreign Co agrees that it will not use the server for any other customer during the term of the agreement and is removed at the end of the agreement.

Although the server is located at NZ Co's facilities, NZ Co accesses the server through Foreign Co's network and the monthly fee remains based on the amount of computing power made available to NZ Co.

Classification

As in Example | Tauira 1, the transaction involves the provision of on-demand network computing capacity and is a cloud computing transaction. This is classified as the provision of services.

Potential tax implications

The potential tax implications are the same as in Example | Tauira 1.

Because the server is located in New Zealand, Foreign Co may have New Zealand–sourced income for providing the use of personal property in New Zealand under s YD 4(8). It could also mean that Foreign Co has a PE in New Zealand (see [68]).

Example | Tauira 6: Access to software development platform and website hosting (PaaS)

Scenario

Foreign Co provides NZ Co with access to a software development platform used to develop and deploy websites with a range of features, including blogs, message boards and other collaborative tools. The platform includes:

- an operating system;
- web server software;
- a software app for managing access to the platform;
- libraries and development tools; and
- back-end relational database software.

NZ Co can use certain visual elements in its websites that are subject to copyrights that Foreign Co holds. Websites created on the platform cannot be exported from the platform and must be hosted by Foreign Co.

The platform and NZ Co's finished websites are hosted on Foreign Co's overseas servers. NZ Co's personnel access the software development platform via a separate software program (access app) that is downloaded on to their devices. They cannot download, access or alter the underlying software code in the platform or the access software.

A small amount of copyrighted scripting code is downloaded onto NZ Co's computers to enable secure logins and access through a standard web browser. All other platform functions execute on Foreign Co's servers.

NZ Co pays Foreign Co a monthly fee for the platform and website hosting.

Classification

In this transaction Foreign Co provides on-demand network access to the software platform. It also:

- hosts NZ Co's finished websites on Foreign Co's servers;
- grants NZ Co, under open-source terms, the right for its websites to use certain visual elements subject to copyrights held by Foreign Co (a transfer of copyright rights); and
- allows NZ Co to download the access software app (a transfer of a copyrighted article).

These additional elements are ancillary and incidental to the access to use the software development platform.

Accordingly, this transaction is classified solely as a cloud computing transaction and the provision of services.

Potential tax implications

The potential tax implications are the same as Example | Tauira 1. This includes that NRCT will not apply because the transaction involves the provision of, in this case, PaaS and Foreign Co does not have non-excluded personnel in New Zealand.

Sale of copyright rights

Discussion

135. Copyright, like any asset, can be sold or transferred by its owner. Section 113 of the Copyright Act 1994 states that copyright is "transmissible" as personal or moveable property by assignment, under a will or by operation of law. This transmission may cover all the rights or only a portion of them.

136. A sale of copyright rights can therefore be restricted to one or more of the exclusive rights held by the copyright owner. It may also be limited to a specific period within

the term of copyright or confined in other ways, such as by geographical scope. In practice, a transaction can involve some combination of these limitations.

137. Because of these possibilities, it can sometimes be challenging to determine whether an agreement is a partial transmission of copyright rights or a grant of a licence. The distinction depends on the circumstances and determining which applies requires a careful analysis of the legal rights and obligations that are created, consistent with the transactional approach described from [14].[52]

138. Despite these complexities, some general distinctions can be drawn between the transmission of a copyright right and the granting of a licence. The following are some key distinguishing characteristics:

- **Ownership:** The ownership of the copyright right is transferred to the purchaser. In contrast, a licence does not transfer ownership.
- **Scope of rights:** The new owner acquires the full legal rights under copyright law for the rights transferred. A licensee, however, only obtains the rights expressly granted under the licence agreement. They can enforce those rights under contract law against the copyright owner or licensor but cannot enforce the copyright under copyright law against third parties.
- **Duration:** Transferred copyright rights endure for the statutory term provided under copyright law. A licensee's rights last only as long as the period specified in the licence agreement and may be terminated under its terms, such as for breach of contract.
- **Payment structure:** A sale or assignment typically involves a one-time payment (but not always) whereas licences usually involve ongoing or periodic payments.

Tax implications

139. A royalty arises from payments for the use of or right to use, copyright-protected property and not from payments for its outright purchase.[53] Also, a sale of copyright rights may generate a capital receipt from the transfer of a fixed capital asset, rather than generate income that may have a New Zealand source.[54]

140. However, the sale proceeds may be taxable if the proceeds are income and deemed to have a New Zealand source under s YD 4. This would primarily occur where the

[52] For example, see *Precast NZ Ltd v Anystep Ltd* [2017] NZHC 1371 at [195] to [200].

[53] See, for example *DB Group Ltd v CIR* (1996) 17 NZTC 12,446 (HC) at 12,450.

[54] Not all capital gains are taxed domestically in New Zealand. Moreover, most DTAs that follow the OECD Model would have a capital gains article (art 13) that generally allocates the taxing right from the alienation of intangible assets other than those of a PE in New Zealand to the jurisdiction in which the non-resident resides.

proceeds represent income from a business carried on in New Zealand (s YD 4(2)) or income from a contract made or performed in New Zealand (s YD 4(3)).

141. These tax implications are subject to the application of any relevant DTA and whether the non-resident has a PE in New Zealand (see discussion on the cross-border aspects of software transactions from [28]).

Example | Tauira 7: Sale of copyright rights

Example | Tauira 7: "Exclusive licence" agreement

Scenario

NZ Co and Foreign Co enter into a written agreement under which Foreign Co transfers to NZ Co certain rights under an "exclusive licence" for the remaining term of the copyright in a computer program. These rights are to:

- copy the program;
- issue an unlimited number of the copies to the public within the geographic area of New Zealand;
- create adaptations or derivative works based on the program; and
- perform or display the software publicly.

The agreement includes the following requirements:

- NZ Co pays Foreign Co a lump sum "royalty" of $3 million.
- Foreign Co agrees to refrain from using or granting others the right to use the software or to grant a licence of the copyright in the software to others for the specified geographical area and term.
- All rights in the copyright in the software revert to Foreign Co if NZ Co breaches the terms of the arrangement.
- Foreign Co transfers a copy of the computer program to NZ Co.

Classification

The transaction involves the transfer of substantial copyright rights. NZ Co has acquired the copyright rights in the program for a specific geographic area and for the full remaining life of the copyright in the program.

Although Foreign Co has supplied a copy of the program (a copyrighted article), this is ancillary or incidental to the main transaction being the transfer of the copyright rights. Accordingly, this part of the transaction is classified as part of the overall transaction, rather than as a separate supply of a copyrighted article.

The use of terms such as "exclusive licence" and "royalty" in the agreement is not determinative of the transaction's true nature. For tax purposes, a royalty is defined as including "consideration derived for the use of or the right to use a copyright". In this case, NZ Co has effectively purchased substantial copyright rights in the program, not merely the right to use them.

Therefore, the transaction is classified as a sale or assignment of copyright rights, not as a licence of those rights.

Potential tax implications if sale by Foreign Co is on revenue account

As this transaction involves a sale, rather than a licence, no royalties arise.

The payment Foreign Co receives is taxable in New Zealand if it constitutes income and has a New Zealand source (eg, income from a business carried on in New Zealand under s YD 4(2) or income from a contract made or performed in New Zealand under s YD 4(3)).

If a DTA applies, the income is not taxable in New Zealand unless the payments are attributable to a PE of Foreign Co in New Zealand.

Licensing copyright rights

Discussion

142. Copyright rights in software are commonly licensed. Licensees typically obtain the right to use the copyright in the program for specific purposes, such as making copies for public distribution or for other forms of commercial exploitation, such as making adaptations.

143. A licence is generally understood as "provid[ing] an excuse for an act which would otherwise be unlawful as, for example, … the infringement of a patent or copyright. It is an authority to do something which would otherwise be wrongful, illegal or inoperative".[55] In the context of copyright rights, a licensee is permitted to exercise only those copyright rights expressly granted under the licence. Any acts beyond the authority of the licence are unlawful.

[55] Latham CJ in *FCT v United Aircraft Corporation* [1943] 2 AITR 458 (HCA) at 464. See also *Edwards v O'Connor* [1991] 2 NZLR 542 (CA) at 550.

144. As noted, distinguishing between a sale of copyright and a licence can be challenging and which applies depends on the facts of the case. However, some general distinctions can be drawn (see [138]).

Tax implications

145. Payments made under a licence to use software copyright generally constitute royalty income for the recipient under para (a) of the definition of a "royalty" in s CC 9, as consideration for the use of, or the right to use, any copyright (see from [42]).

146. These payments may also have a New Zealand source as income under s YD 4(9) (Royalties). Other source rules could apply, such as if the amount is from a business carried on in New Zealand (s YD 4(2)) or is income derived from a contract made or performed in New Zealand (s YD 4(3)). However, if a DTA applies and the royalty is attributable to the non-resident's PE in New Zealand it is taxable under the business profits article of the relevant DTA (see discussion from [65]).

147. As noted, royalties that a non-resident derives from New Zealand are subject to NRWT at a rate of 15% on the gross payments. Under the royalties article of an applicable DTA, this rate is likely to reduce to 5% or 10%, unless the royalty is attributable to a PE.

148. Payers of royalties to non-residents must also supply investment income information to the Commissioner.

149. Licensing software may involve the non-resident providing the use of, or right to use, in New Zealand, personal property. This raises the question of whether NRCT applies. However, NRCT does not apply to royalties because the definition of "contract payment" in s YA 1 for NRCT purposes expressly excludes royalties.

Examples |Tauira 8–9: Licensing copyright rights

Example | Tauira 8: Licence of a right to copy and sell software

Scenario

NZ Co and Foreign Co enter into a written agreement. Foreign Co grants NZ Co a non-exclusive right to:

- make unlimited copies (or to authorise the copying) of a computer program owned by Foreign Co; and
- sell those copies to customers in New Zealand via electronic download.

NZ Co will pay a regular fee based on the number of copies sold. The agreement is for 2 years, which is less than the remaining life of the copyright. Foreign Co transfers a copy of the computer program to NZ Co for this purpose.

Classification

Several factors indicate that this transaction involves a licence of copyright:

- **Ownership:** Ownership of the copyright rights has not been transferred. Foreign Co retains the ability to grant other licences, including in New Zealand. It can enforce copyright against third parties or sell the rights, subject to NZ Co's interest.
- **Scope of rights:** NZ Co's rights are confined to those granted under the agreement.
- **Duration**: NZ Co's rights are determined contractually and expire after 2 years.
- **Payment structure:** Regular payments based on usage indicate the transaction involves a licence rather than a sale.

The transfer of the copy of the program (ie, a copyrighted article) is ancillary or incidental to the licence of the copyright rights, rather than being a separate transfer of a copyrighted article.

In this example, the program has been licensed to NZ Co and the payments made are consideration for the right to use copyright, which qualifies as a royalty.

The outcome is the same if NZ Co distributed copies of the software on physical media (eg, disks) instead of, or as well as, the electronic download option.

Potential tax implications

Payments that Foreign Co receives are taxable in New Zealand if they have a New Zealand source (eg, they are royalties under s YD 4(9) or income from a business carried on in New Zealand under s YD 4(2) or income from a contract made or performed in New Zealand under s YD 4(3)).

If a DTA applies, the income is not taxable to Foreign Co unless it is attributable to a PE in New Zealand.

NRWT applies as a final tax at 15% to the payments unless reduced to 5% or 10% under a DTA and Foreign Co has no PE in New Zealand to which the property giving rise to the royalties is effectively connected.

NZ Co may have an obligation to report investment income information where withholding taxes apply.

Example | Tauira 9: Computer manufacturer – licence to copy and sell

Scenario

NZ Co is engaged in the manufacture and sale of personal computers in New Zealand. Under the terms of an agreement with Foreign Co:

- Foreign Co supplies NZ Co with a disk containing a computer program;
- NZ Co is granted a non-exclusive right to copy the program onto the hard drives of computers it manufactures; and
- NZ Co is permitted to distribute the copies (on the hard drives) to the public.

The agreement has a 2-year term, which is shorter than the remaining life of the copyright in the program.

NZ Co pays Foreign Co an amount based on the number of copies of the program it installs on its computers.

Classification

NZ Co has not acquired substantial rights in the copyright in the program. For instance, the agreement's term is shorter than the remaining commercial life of the copyright. NZ Co has, however, acquired a copyright right that it can exploit by copying the program on to the hard drives of the computers it manufactures and sells.

Foreign Co's transfer of the physical copy of the program on a disk to NZ Co is an ancillary or incidental part of the overall transaction, which is the transfer of the copyright right.

Therefore, the arrangement constitutes a licence of the copyright to NZ Co rather than a sale of the copyright (or a transfer of a copyrighted article).

This conclusion would remain the same even if NZ Co included a back-up copy of the program on a disk with each computer. For a contrasting situation, see Example | Tauira 11 (Computer manufacturer – copyrighted articles).

Potential tax implications

The potential tax implications are the same as those in Example | Tauira 8 (Licence of a right to copy and sell software).

Sale of copyrighted articles

Discussion

150. The ownership of a copyrighted article is distinct from the ownership of the copyright itself. A supply of a copyrighted article gives the customer the right to use the program for personal or business use. It typically does not transfer any copyright rights, which remain with the owner of the original work.

151. Typically, the article is supplied in perpetuity, subject to any conditions on its use (eg, prohibiting the making and selling of copies). Such restrictions, however, do not affect the classification of the transaction as a sale, just as similar restrictions do not affect the treatment of a sale of a book.

152. Many copyrighted article transactions include an EULA (see from [86]). Generally, the terms of an EULA assert the copyright owner's rights rather than allowing exploitation of the copyright and the terms make it clear that such exploitation is prohibited.

153. When distinguishing between a sale and a lease of a copyrighted article, it is necessary to consider whether the transfer of the copyrighted article involves the transferor giving up all ownership rights (ie, a complete alienation) or just transferring possession for a defined period.

154. A sale of a copyrighted article also includes situations where the copy of the software is built into another product (eg, a computer or car) and sold without any rights in the copyright in the software. This situation may be referred to as involving "integrated" software (see discussion from [108]).

155. The copyright owner may directly make a sale of a copyrighted article, or they may sell articles through another non-resident acting as a marketplace or platform (eg, app stores). From the New Zealand customer's perspective, the cross-border payment is still for the purchase of a copyrighted article.

Tax implications

156. A payment for the sale of a copyrighted article is a sale of goods and not a royalty because it is not consideration for the right to use copyright rights. This includes where the copyrighted article is acquired by downloading the article as digital content. Such payments are unlikely to be taxable to the non-resident software supplier unless they are deemed to have a source in New Zealand under s YD 4. The latter situation could occur where the payment is classified either as income from a business carried on in New Zealand (s YD 4(2)) or as income from a contract made or performed in New Zealand (s YD 4(3)). However, New Zealand tax may not arise if a DTA applies and the non-resident does not have a PE in New Zealand (see discussion from [65]).

Examples | Tauira 10–15: Sale of copyrighted articles

Example | Tauira 10: Sale of computer game disks or downloads

Scenario

Foreign Co owns the copyright in a computer game program and makes copies available for purchasers to download from its website.

Purchasers accept a "click-wrap licence" (EULA) by clicking "I agree" on a dialogue box. The licence is stated to be perpetual. The EULA prohibits reverse engineering, decompilation or disassembly of the program.[56] It permits purchasers to make a single backup copy of the software on a disk that they cannot on-sell. NZ Co purchases a copy of the software.

Classification

No copyright rights are transferred in this transaction. The EULA does not alter this conclusion. NZ Co receives a copy of the program, making it the owner of a copyrighted article. Therefore, this is a sale of a copyrighted article.

Variation

The outcome would be the same if Foreign Co had shipped disks to customers instead of providing downloads. The method of delivery (disk vs download) does not affect the way the transaction is classified.

Potential tax implications

The payment Foreign Co receives is taxable in New Zealand if it is in the nature of income and has a New Zealand source (eg, income from a business carried on in New Zealand under s YD 4(2) or income from a contract made or performed in New Zealand under s YD 4(3)).

If a DTA applies, the income is not taxable to Foreign Co unless it is attributable to a PE Foreign Co has in New Zealand.

Variation – copies of the game software on disks sold via a distributor

NZ Co, a New Zealand resident distributor, buys copies of the computer game program on disks from Foreign Co and sells them to retailers for on-sale to end-users.

[56] Reverse engineering is the broad process of analysing software to understand its design, architecture and functionality. Decompilation and disassembly are techniques that may be used in that process.

NZ Co acquires no copyright rights in the program, only copies of the program. This remains a sale of copyrighted articles.

Potential tax implications

The potential tax implications are the same as the original scenario.

Example | Tauira 11: Computer manufacturer – copyrighted articles

Scenario

The facts are largely the same as Example | Tauira 9 (Computer manufacturer – licence to copy and sell) where NZ Co manufactures and sells personal computers in New Zealand under an agreement with Foreign Co.

However, this example includes the following key differences:

- Foreign Co supplies NZ Co with shrink-wrapped boxes of disks of a computer program, rather than a single disk as in Example | Tauira 9.
- The boxes are identical to those that Foreign Co sells to end-users elsewhere and include a disk accompanied by an EULA similar to the one in Example | Tauira 10 (Sale of computer game disks or downloads), which places restrictions on copying.
- Foreign Co grants NZ Co the non-exclusive right to open the boxes and install each copy of the program onto the hard drive of the computers it manufactures. NZ Co is permitted to distribute both the installed copy and the original disk when selling computers to the public.
- Each disk may be used only once to install a single copy of the program on a computer.

The agreement lasts for 2 years, which is shorter than the remaining life of the copyright in the program. NZ Co pays Foreign Co based on the number of copies installed.

Classification

No copyright rights are transferred. NZ Co obtains the disks without the right to commercially exploit Foreign Co's copyright rights (eg, it has no right to reproduce and distribute publicly further copies of the program). NZ Co is acting much as an intermediary in relation to the distribution of the copies of the programs.

NZ Co is treated as the owner of copyrighted articles and the transaction is classified as the sale of copyrighted articles.

Variation

NZ Co installs the software onto each computer using a single primary copy and provides customers with an unopened, boxed copy of the software with each machine.

Provided NZ Co is not allowed to install the program on more computers than the number of disks purchased, the outcome is the same as above.

Potential tax implications

The potential tax implications are the same as those in Example | Tauira 10.

Example | Tauira 12: Site, network or enterprise licence

Scenario

Foreign Co supplies a copy of a computer program to NZ Co and grants a site licence allowing:

- installation of copies of the program on 50 workstations for NZ Co employees to use at one location; and
- new installations on further workstations at any time for an extra one-time fee per user.

The licence:

- is perpetual;
- permits use on NZ Co’s workstations at the specified site only; and
- prohibits the selling of copies or reverse engineering of the program.

Classification

Granting a right to copy without the ability to commercially exploit the supplier’s copyright – as occurs in this example where copying the program is restricted – is not treated as a grant of a copyright right.

NZ Co is treated as the owner of the copyrighted articles, meaning this is a sale of copyrighted articles, not a lease (or involving royalties).

Restrictions on resale do not override other factors, such as the supplier retaining the risk of loss and NZ Co’s right to use the copies in perpetuity, in terms determining this transaction is a sale of copyrighted articles, not a lease.

Therefore, this transaction is treated as a transfer of copyrighted articles (50 copies of the program).

The same outcome applies to network or enterprise licences, provided NZ Co does not obtain rights to commercially exploit Foreign Co's copyright rights.

The key determinant is whether NZ Co can commercially exploit the supplier's copyright rights. It is not the number of copies provided or the extent that they are provided.

Potential tax implications

The potential tax implications are the same as those in Example | Tauira 10 (Sale of computer game disks or downloads).

Example | Tauira 13: Site, network or enterprise licence — modified program

NZ Co enters into a contract with Foreign Co for software licensing, similar to the arrangement in Example | Tauira 12 (Site, network or enterprise licence). Foreign Co agrees to modify its program by rewriting parts of the program to meet New Zealand accounting standards so NZ Co can use it at its facility in New Zealand. The agreement specifies that Foreign Co retains all copyright rights in the modified program.

NZ Co acquires a single copy of the modified program with rights to install it on 500 workstations.

Classification

As in Example | Tauira 12, no copyright rights are transferred under this arrangement. The modifications Foreign Co makes before transferring the program to NZ Co do not constitute the provision of services for the development or modification of software because Foreign Co retains all copyright rights in the modified version of the software.

This transaction is classified, therefore, as a sale of copyrighted articles (500 copies of the program).

Considering all the facts and circumstances, NZ Co is properly treated as the owner of copyrighted articles. The transaction is classified as a sale of copyrighted articles.

Potential tax implications

The potential tax implications are the same as those in Example | Tauira 10 (Sale of computer game disks or downloads).

Example | Tauira 14: Software development tools — including libraries

Scenario

Foreign Co transfers a copy of a computer program to NZ Co in exchange for a single fixed payment. The program is a software development tool designed to help create other applications. It includes several components, such as libraries of reusable code that act as foundational building blocks for new software. No element of these libraries is a significant component of any overall new program. Because a computer program created with the development tool will not operate unless the libraries are also present, the licence agreement grants NZ Co the right to distribute copies of the libraries with any program developed using the tool.

Classification

NZ Co has received a copy of the program and has therefore received a copyrighted article. Considering the overall transaction and the surrounding facts and circumstances, the right to distribute the libraries in conjunction with any programs created using the development program is an ancillary or incidental part of the overall transaction, which is the transfer of the copyrighted article. Therefore, the transaction is treated solely as a transfer of a copyrighted article and not a copyright right. Considering all the facts and circumstances, NZ Co is properly treated as the owner of a copyrighted article. Therefore, there has been a sale of a copyrighted article.

Potential tax implications

The potential tax implications are the same as those in Example | Tauira 10 (Sale of computer game disks or downloads).

Example | Tauira 15: Correction of errors in software

Scenario

Under the terms of a licence agreement, Foreign Co provides to NZ Co a copy of one of its software programs, including its object code and the source code. The licence agreement grants NZ Co the right to:

- modify the source code in order to correct minor errors and make minor adaptations to the program so that it will function on NZ Co's computer; and
- recompile the modified source code.

The licence does not grant NZ Co the right to distribute the modified program to the public.

Classification

NZ Co has received a copy of the program and has therefore received a copyrighted article. The right to modify and recompile the source code in order to create new code to correct minor errors and make minor adaptations does not infringe copyright.[57] This right is simply an ancillary or incidental part of the overall transaction, which is the transfer of the copyrighted article. Therefore, the transaction is properly treated solely as the transfer of a copyrighted article and not of a copyright right. Considering all the facts and circumstances, NZ Co is properly treated as the owner of a copyrighted article. Therefore, there has been a sale of a copyrighted article.

Potential tax implications

The potential tax implications are the same as those in Example | Tauira 10 (Sale of computer game disks or downloads).

Leasing copyrighted articles

Discussion

157. Where a copy of a computer program (ie, a copyrighted article) is supplied for a finite period without accompanying copyright rights in the program, this transaction is commonly referred to as a "lease". While this arrangement shares some characteristics of a lease – such as providing a legal right of exclusive possession for a specified period – it is more accurately characterised in law as a "bailment" or "hire", given that it does not relate to land.

158. A bailment can take various forms but typically involves hiring goods and is sometimes referred to as a "chattel lease". Usually, when hiring goods, a person obtains the right to use an item in exchange for rental payments to the owner. A "chattel lease" is a more recent type of agreement. Although it is not technically a "lease" (because it does not relate to land), it is a contractual arrangement that may confer some equitable interest in the item.[58] This guideline refers to payments made under a chattel lease as rental payments.

159. When a person obtains the right to use software for a finite period – without any right to commercially exploit the copyright rights – the rights and obligations created are

[57] See s 80B of the Copyright Act 1994.

[58] See *Bristol Airport plc v Powdrill* [1990] 2 All ER 493 (EWCA) at 502.

equivalent to those in a lease. Accordingly, it is the Commissioner's view that such transactions should be treated as a lease for income tax purposes.

Tax implications

160. Although the tax implications of a transaction ultimately depend on the specific facts, rental payments under a chattel lease of a copyrighted article of software may give rise to several possible outcomes, as noted below.

Payments may have a New Zealand source

161. Under s YD 4, the payments may have a source in New Zealand if they are income from a business carried on in New Zealand (s YD 4(2)) or from a contract made or performed in New Zealand (s YD 4(3)). They may also have a New Zealand source if they are for the use of personal property in New Zealand (s YD 4(8)).

162. However, taxation in New Zealand may not arise if a DTA applies and the non-resident does not have a PE in New Zealand (see discussion from [65]).

Payments may be subject to a withholding tax as non-resident contractor's income

163. A non-resident contractor may have withholding tax obligations where s YD 4(8) applies. This is because, the payments may also be consideration for a non-resident contractor undertaking to supply the use of, or right to use, in New Zealand, any personal property (see discussion from [56]).

Payments may be royalties for the right to use certain equipment

164. Lease payments derived by non-resident "lessors" of computer programs, may fall within the royalties article of certain New Zealand DTAs. This is because some DTAs define royalties to include payments made "as a consideration for the use of, or the right to use, … industrial, commercial, or scientific equipment".[59] In such cases, New Zealand may have a taxing right, typically limited to 5% or 10%.

165. Although leased computer software does not, by itself, constitute industrial, commercial or scientific equipment, it may form an integral part of such equipment. The Commissioner considers that a functionality test should be applied to determine this. Software is integral if it is critical or essential to the equipment's function. The following questions are relevant to establishing whether it is integral:

[59] Some DTAs modify the royalties article by placing a limit in the protocol to the DTA as to when a royalty arises. That is, a royalty only arises when the payments are based on some measure of the extent of the use of the equipment.

- Is the software part of the means by which the equipment performs its function?
- Does the equipment run the software, or is the software required for the equipment to operate?

166. If the software is essential to the operation of the equipment, then it is regarded as an integral part of that equipment (eg, firmware for a laptop). While this typically occurs where the software is integrated into an identifiable item of equipment, it can also apply where the software remains separate from the equipment but is still essential to its operation.

167. If the lease payments are treated as royalties under a DTA, they may also fall within the non-resident schedular payment rules because they relate to the use of, or right to use, in New Zealand, personal property. As a result, theoretically two types of withholding tax could apply (NRWT and NRCT). However, the DTA takes precedence, and the applicable withholding tax rate is the lower rate for NRWT specified in the royalties article of the relevant DTA – rather than the 15% rate or any other domestic rate. This assumes the lease payments are not business income attributable to a PE in New Zealand.

168. If the lease payments constitute business income attributable to a PE in New Zealand, then what is typically art 12(3) of a relevant DTA applies. That article defers to what is typically art 7, and taxation rights are allocated under the business profits article with the lease income taxable in New Zealand as part of the income from the PE. Consequently, the full rate of the non-resident schedular payment withholding obligation may still apply.

Subject to withholding tax as "interest" from a "finance lease"

169. The hire or lease of a copy of software from a non-resident supplier may come within the definition of a "finance lease" in s YA 1 and be treated for income tax under the rules in ss FA 6 to FA 11 and FA 11B. Under these rules, the lease is treated as an effective sale of the software to the lessee, with the non-resident supplier providing a loan back to the lessee. Each lease payment is split into a principal repayment reducing the loan and an interest portion.

170. The interest portion is treated as income derived by the non-resident supplier and included in their gross income under s CC 4(1). Interest income that a non-resident derives from New Zealand may be subject to NRWT or RWT where there is a fixed establishment (see [50]).

171. However, if a DTA applies, the RWT rate or the standard 15% NRWT rate may be reduced (typically to 10%), unless the payments are attributable to a PE in New Zealand.

Combinations of circumstances

172. A number of the above tax implications can overlap. For instance, a finance lease may exist in circumstances where a DTA treats the gross rental payments as royalties under the royalties article on the basis that they are being made for the use of, or the right to use, industrial, commercial or scientific equipment. In such cases, the Commissioner's view is that the domestic characterisation of the transaction as a sale of the lease asset under the finance lease rules precludes the possibility that the payments are also seen under a DTA as being for the use of the software integrated into the equipment. Consequently, only the interest article of the DTA applies.

173. Similarly, a finance lease characterisation applies for all purposes of the Act. Therefore, lease payments treated as repayments of principal and interest cannot also be seen as payments for the use of, or right to use in New Zealand, personal property and subject to withholding tax as non-resident contractor schedular payments.

Examples | Tauira 16–18: Leasing copyrighted articles

Example | Tauira 16: Lease transaction – physical delivery of disk

Scenario

The facts are similar to those in Example | Tauira 10 (Sale of computer game disks or downloads), except that NZ Co obtains a physical disk, rather than downloading the game program, and pays Foreign Co to use it for a period of only 2-months. After 2 months, NZ Co must return the disk containing the program to Foreign Co and destroy any copies made.

Classification

No copyright rights have been supplied in this transaction. NZ Co receives only a copy of the program and is therefore treated as having acquired the use of a copyrighted article for a finite period. Based on all of the facts and circumstances, NZ Co is not regarded as the owner of the article. Accordingly, the arrangement is classified as a lease of a copyrighted article, rather than a sale.

The outcome will not change even if NZ Co were required to destroy the disk at the end of the 2-month period instead of returning it. This is because Foreign Co can make additional copies of the program at minimal cost for future leases.

Foreign Co has provided NZ Co with the use or right to use personal property in New Zealand.

Potential tax implications

The payments Foreign Co receives are taxable in New Zealand if they have a New Zealand source (eg, from a business carried on in New Zealand under s YD 4(2), from a contract made or performed in New Zealand under s YD 4(3) or from the use of personal property in New Zealand under s YD 4(8)).

If a DTA applies, the income is not taxable to Foreign Co unless the payments are attributable to a PE in New Zealand.

NRCT applies to the payments. A special rate or an exemption might be available if DTA relief applies. Depending on the amount of the payments, the exception applying to payments below a certain threshold in a 12-month period may also apply (see [61]).

Example | Tauira 17: Lease transaction – electronic delivery of software

Scenario

The facts are largely the same as those in Example | Tauira 10 (Sale of computer game disks or downloads), except that the copies of the game software are downloaded electronically from Foreign Co's website. NZ Co may use the program for 2 months, after which an electronic lock disables access.

Classification

NZ Co does not receive any copyright rights. It only receives a copy of the program, and the method of transmission (electronic or physical) does not affect the transaction's classification. Therefore, NZ Co has received a copyrighted article.

As in Example | Tauira 16, (Lease transaction – physical delivery of disk), NZ Co is not treated as the owner of a copyrighted article. Although the program remains on NZ Co's computer at the end of the 2-month period, NZ Co no longer has the legal right to use it without further payment and cannot access it without the electronic key. In effect it is as if the program were no longer on the hard drive. Although it differs from the requirement in Example | Tauira 16 to physically return the disk, the outcome in this case is the same.

Accordingly, there has been a lease of a copyrighted article, rather than a sale.

Potential tax implications

The potential tax implications are the same as those in Example | Tauira 16.

Example | Tauira 18: Lease of program – site, network or enterprise transaction

Scenario

The facts are largely the same as those in Example | Tauira 12 (Site, network or enterprise licences), except that NZ Co pays Foreign Co a monthly fee based on the permitted maximum number of users, which can be altered.

Either party may terminate the agreement at the end of any month. Upon termination, NZ Co must delete or destroy all copies of the current version of the program. The agreement expressly states that NZ Co has no option to purchase the program.

Classification

NZ Co has not received any copyright rights. It has received a copyrighted article and, as with the preceding two examples, NZ Co is not treated as the owner of that article.

NZ Co's rights are limited to using the program while payments continue. It does not have:

- the right to use the program in perpetuity;
- an option to purchase the program after paying a certain amount or after a certain period (which could indicate a sale); or
- the right to on-sell the software.

Once the agreement is terminated, NZ Co will no longer possess any copies of the program, either current or superseded.

Therefore, the transaction is a lease of a copyrighted article.

Potential tax implications

The potential tax implications are the same as those in Example | Tauira 16 (Lease transaction – physical delivery of disk).

Note: The outcome would differ if NZ Co were entitled to retain the latest version of the program upon termination of the agreement. In that case, the transaction would be treated as a sale of a copyrighted article, rather than a lease.

Supply of know-how

Discussion

174. The term "know-how" is difficult to define with any precision. Lord Radcliffe in the House of Lords has provided one leading description, which has been summarised as follows:[60]

> "Know-how" is the fund of technical knowledge and experience acquired by a highly specialised production organisation; although it may be, and usually is, noted down in documents, drawings, etc., it is itself an intangible entity whose category may vary according to, and may even be determined by, its use. Like office or factory buildings, patents and trademarks, and goodwill, it may be described as a "capital asset" while it is retained by a manufacturer for his own purposes, but, unlike these, its supply to another is not a transfer of a fixed capital asset because it is not lost to the supplying manufacturer (*Rolls-Royce v Jeffrey; Rolls-Royce v I.R.C.* [1962] 1 All E.R. 801).

175. Know-how is an intangible asset that, in practical terms, represents undisclosed knowledge or information held by the supplier that enables a product or process to be replicated. It refers to knowledge or information that cannot be obtained simply by examining a product or by knowing the process or technique. In the context of computing, know-how is best described as information relating to computer programming techniques – that is specialised knowledge that goes beyond what is apparent from the software itself.

176. Know-how cannot be sold outright, in the sense that the supplier loses the right to use the special knowledge provided. The supplier retains the ability to use it.[61] It is also important to distinguish know-how from the physical or electronic medium through which it is transmitted. While know-how may subsist in a computer program, that alone does not constitute a supply of the know-how. A true supply of know-how involves transferring the seller's special knowledge or information that remains unknown to the public.

177. If the software transaction does not purport to transfer relevant know-how, however it is comprised, the transaction is not a supply of know-how simply because the software has been provided. Know-how is an intangible asset of the seller, and the seller receives value from the buyer in exchange for its disclosure. Typically, know-how is supplied under conditions preventing the buyer from disclosing it without authority and any disclosure would constitute a breach of confidence.

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[60] *Stroud's Judicial Dictionary of Words and Phrases* (11th ed, Sweet and Maxwell London, 2023) at 545–546.

[61] *Moriarty v Evans Medical Supplies Ltd* [1957] 3 All ER 718 (HL) at 735.

178. Payments for know-how differ from payments for services, although the distinction is not always straightforward and it depends on the facts in each case. In a know-how transaction, the supplier transfers special knowledge or information enabling the buyer to use it for their own benefit. In contrast, when providing services, the supplier applies their knowledge or information on behalf of the buyer.

179. The OECD Model commentary on art 12 (Royalties) discusses know-how in the context of software as follows:

> 11.5 In the particular case of a contract involving the provision, by the supplier, of information concerning computer programming, as a general rule the payment will only be considered to be made in consideration for the provision of such information so as to constitute know-how where it is made to acquire information constituting ideas and principles underlying the program, such as logic, algorithms or programming languages or techniques, where this information is provided under the condition that the customer not disclose it without authorisation and where it is subject to any available trade secret protection.
>
> 11.6 In business practice, contracts are encountered which cover both know-how and the provision of technical assistance. One example, amongst others, of contracts of this kind is that of franchising, where the franchisor imparts his knowledge and experience to the franchisee and, in addition, provides him with varied technical assistance, which, in certain cases, is backed up with financial assistance and the supply of goods. The appropriate course to take with a mixed contract is, in principle, to break down, on the basis of the information contained in the contract or by means of a reasonable apportionment, the whole amount of the stipulated consideration according to the various parts of what is being provided under the contract, and then to apply to each part of it so determined the taxation treatment proper thereto. If, however, one part of what is being provided constitutes by far the principal purpose of the contract and the other parts stipulated therein are only of an ancillary and largely unimportant character, then the treatment applicable to the principal part should generally be applied to the whole amount of the consideration.

180. In summary, the provision of information about a computer program is treated as the supply of know-how only if the information is:

- relating to computer programming techniques;
- furnished under conditions preventing unauthorised disclosure;
- specifically contracted for between the parties; and
- considered property subject to trade secret protection (ie, that unauthorised disclosure constitutes a breach of confidence).

Tax implications

181. A payment derived as consideration for the supply of "scientific, technical, industrial, or commercial knowledge or information" (commonly referred to as "know-how"[62]) is a royalty under para (f) of the "royalty" definition in s CC 9(2). Accordingly, the tax implications are generally the same as those that arise under a software licensing transaction (see from [145]).

182. Royalties received by a non-resident have a New Zealand source under s YD 4(9). The payments may also have a New Zealand source as income from a business carried on in New Zealand (s YD 4(2)) or as income derived from a contract made or performed in New Zealand (s YD 4(3)).

183. Taxation in New Zealand may not arise if a DTA applies and the non-resident does not have a PE in New Zealand (see discussion from [65]).

184. As noted, royalties that a non-resident derives from New Zealand are subject to NRWT at 15%. Under the royalties article of an applicable DTA, this rate is likely to be reduced, typically to 5% or 10%. Additionally, anyone paying royalties to non-residents must supply investment income information to the Commissioner.

Example Tauira 19: Supply of know-how

Example | Tauira 19: Programming techniques know-how

Scenario

Foreign Co and NZ Co agree that Foreign Co will remotely provide information on certain programming techniques that are not generally known to computer programmers, to enable NZ Co to create computer programs more efficiently. These techniques represent the product of experience Foreign Co gained from working on many similar computer programming projects and Foreign Co provides them to NZ Co under non-disclosure conditions. The information is considered to be subject to trade secret protection.

Classification

This transaction is the provision of know-how. This is because it entails the supply of confidential special knowledge and information subject to trade secret protection that

[62] "Know-how" is defined in s YA 1 but only in relation to tax credits for research and development tax losses under subpart MX.

relates to computer programming techniques, and it is supplied under non-disclosure conditions.

Potential tax implications

The payments Foreign Co receives are taxable in New Zealand if they have a New Zealand source, such as from royalties under s YD 4(9), or as income from a business carried on in New Zealand under s YD 4(2) or income from a contract made or performed in New Zealand under s YD 4((3).

If a DTA applies, the income is not taxable in New Zealand unless the payments are attributable to a PE that Foreign Co has in New Zealand.

NRWT applies at 15% to the payments unless a reduced rate (typically 5 or 10%) applies under a DTA and Foreign Co has no PE in New Zealand to which the property giving rise to the royalties is effectively connected.

NZ Co may have an obligation to report investment income information where withholding taxes apply.

Supply of development, modification or other services

Discussion

185. Software may need to be developed or modified during its commercial life. Non-residents may be engaged to perform these tasks, and typically they are supplying a service to the owner or user of the program. Similarly, non-residents instead of New Zealand value-added resellers may be engaged to provide additional customer services (see [103]). Other services in this context may also include services provided by a non-resident that are not necessarily provided in a cloud computing context, such as help desk technical support, maintenance support or training.

186. As noted in the discussion of know-how from [174], when providing services, the service provider uses its knowledge or information to perform work, such as developing or modifying software, for the benefit of the customer. A service is generally understood as an activity that helps or benefits another party, such as professional assistance. This view aligns with the concept of supplying a service for the purposes of the Goods and Services Tax Act 1985.[63]

[63] See, for example, *Case S65* (1996) 17 NZTC 7,408 (NZTRA).

187. Certain factors may suggest a transaction involves a supply of services. One example is where the development or modification work benefits the customer and they own the copyright in those modifications.

Tax implications

188. The tax implications of a transaction involving the supply of services will depend on the facts of the particular transaction. In general, payments for the supply of services to develop or modify computer programs are not likely to be taxable to the non-resident software supplier unless the income is deemed to have a source in New Zealand under s YD 4. Primarily, this situation could arise if the payment is income from a business carried on in New Zealand (s YD 4(2)) or from a contract made or performed in New Zealand (s YD 4(3)).

189. However, taxation in New Zealand may not arise if a DTA applies and the non-resident does not have a PE in New Zealand (see discussion from [65]).

190. In addition, the non-resident might perform the supply of the service in New Zealand. Subject to whether full relief under a DTA applies, this raises the possibility that the non-resident is a non-resident contractor, the payments are non-resident contractors schedular payments and the payer has an obligation to withhold tax.

191. Also noted from [47], a royalty can include a supply of assistance that enables the payer to apply or use anything that itself gives rise to a royalty. Accordingly, other services may, at times, give rise to royalties rather than be characterised as the provision of a service. If royalties arise, the tax implications are as previously mentioned and relate to NRWT which may be taxed at a reduced rate of 5% or 10% if a DTA applies (see discussions from [50] and from [71]).

Examples | Tauira 20–22: Supply of development, modification or other services

Example | Tauira 20: Provision of development or modification services

Scenario

NZ Co enters into an agreement with Foreign Co for a new computer program. Key terms are as follows:

- Foreign Co will develop the program for NZ Co based on NZ Co's specifications.
- When the agreement ends, any procedures, techniques or copyrightable interests in the program are the property of NZ Co.
- NZ Co agrees to pay a fixed monthly sum during development.

- NZ Co may cancel the contract at the end of any month if dissatisfied with progress and retains any rights in intellectual property created to that point. Foreign Co will retain all payments made up to the date of termination.
- The agreement is referred to as a licence agreement with all the payments made under it described as royalties.
- There is no continuing relationship (eg, updates or maintenance) between the two companies after the completion of the work.

Classification

Foreign Co is supplying services to NZ Co. NZ Co bears all development risks and owns all of the copyright rights in the software. Neither the fact that the agreement is labelled a licence nor the fact that the payments are called royalties, is determinative.

Potential tax implications

The payments Foreign Co receives are taxable in New Zealand if they have a New Zealand source (eg, from a business carried on in New Zealand under s YD 4(2) or a contract made or performed in New Zealand under s YD 4(3)).

If a DTA applies, Foreign Co is not taxed in New Zealand unless the income is attributable to a PE in New Zealand.

Example | Tauira 21: Supply of other services – para (h) of s CC 9 (Royalties)

The facts are the same as in Example | Tauira 8 (Licence of a right to copy and sell software):

- NZ Co and Foreign Co enter into a written agreement. Foreign Co grants NZ Co a non-exclusive right for the unlimited copying (or authorisation of copying) of a computer program owned by Foreign Co and selling the copies by way of electronic download in New Zealand. NZ Co will pay a regular fee for this right based on the number of copies sold. The agreement is for two years, which is less than the remaining life of the copyright.
- Foreign Co transfers a copy of the computer program to NZ Co.

In this example, however, the written agreement also provides for NZ Co to pay Foreign Co a fixed monthly fee for remotely provided assistance in relation to the software.

Classification

The arrangement has two components. First, as per the classification applied in Example | Tauira 8, the transaction involves a licence of copyright rights. Second, the assistance is a supply of services provided as a means of enabling NZ Co to use the copyright licence.

All the payments under this arrangement are royalties. The regular payments made by NZ Co based on the number of copies of the program sold in New Zealand are royalties under paragraph (a) of s CC 9(2). The fixed monthly fee is also a royalty under paragraph (h) of s CC 9(2) as they are payments made as consideration for the supply of assistance that enables the application or use of the copyright rights licenced under the arrangement.

Potential tax Implications

The payments Foreign Co receive are taxable in New Zealand if they have a New Zealand source (eg, from royalties under s YD 4(9), or from a business carried on in New Zealand under s YD 4(2) or from a contract made or performed in New Zealand under s YD 4(3)).

However, if a DTA applies, the income is not taxable to Foreign Co unless the payments are attributable to a PE it has in New Zealand.

NRWT applies at 15% to the payments unless a reduced rate of 5% or 10% applies under a DTA and Foreign Co has no PE in New Zealand.

RWT may apply instead of NRWT if Foreign Co has a fixed establishment in New Zealand (either instead of or in addition to a PE in New Zealand).

NZ Co may have an investment income information reporting obligation where withholding taxes apply.

Example | Tauira 22: Supply of other services – cloud computing arrangement

Scenario

The facts are largely the same as Example | Tauira 1 (SaaS arrangement with New Zealand customer), except that they incorporate a New Zealand reseller and the New Zealand SaaS customer (NZ Co) contracts directly with a non-resident for the following additional customer services, rather than obtaining through the reseller:

- consulting and advisory services relating to implementation; and
- configuration and customisation of the SaaS product.

The non-resident in this example need not be the cloud services provider, particularly if it has a New Zealand-based VAR providing the same additional customer services.

Classification

The non-resident neither provides know-how nor grants NZ Co any intellectual property rights, including rights in the SaaS software, in which it may hold no rights. Instead, the non-resident uses its knowledge and expertise to perform services for NZ Co's benefit. Accordingly, the arrangement is one for the provision of services.

Potential tax implications

The payments the non-resident receives are taxable in New Zealand if they have a New Zealand source (eg, they are from a business carried on in New Zealand under s YD 4(2) or from a contract made or performed in New Zealand under s YD 4(3)).

If a DTA applies, the non-resident is not taxed in New Zealand unless the income is attributable to a PE in New Zealand.

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About this document | Mō tēnei tuhinga

The Tax Counsel Office issue interpretation guidelines. Interpretation guidelines set out the Commissioner's views and guidance on a general area of law that gives rise to tax implications. While they set out the Commissioner's considered views, Interpretation guidelines are not binding on the Commissioner. However, taxpayers can generally rely on them in determining their tax affairs. See further Status of Commissioner's advice (Commissioner's Statement, Inland Revenue, December 2012*)*. It is important to note that a general similarity between a taxpayer's circumstances and an example in an interpretation guideline will not necessarily lead to the same tax result. Each case must be considered on its own facts.

Appendix – Summary of software transaction classifications

Transaction:	Classification of cross-border payments:	Potential tax outcomes:
1. Supply of cloud computing services	**Service** Supply to New Zealand end-users of on-demand access to configurable computing resources. **Service** Supply to New Zealand basic resellers and some VARs of the right to resell such access to New Zealand end-users. **Mixed transaction – service and royalty** Supply to some New Zealand VARs where the reselling arrangement involves licensing of copyright rights or other intellectual property or supplies of know-how. **Royalty** Supply to some New Zealand non-resellers providing additional customer services similar to VARs where the payment involves licensing of copyright rights or other intellectual property or supplies of know-how. **Royalty** Supply to New Zealand resident cloud computing provider for the right to use a non-resident copyright owner's software to provide access to New Zealand end-users.	*New Zealand–sourced income* • If a DTA applies, the income is generally not taxable unless attributable to a permanent establishment (PE) in New Zealand. • If no DTA applies, the income is taxable (eg, from business or contracts or for use of personal property under s YD 4(2), (3), or (8)). *Withholding tax* • No non-resident contractors' schedular payment withholding tax (NRCT) applies, except to the extent that the service involves personnel in New Zealand (other than personnel excluded under s RD 8(1)(b)(v)). • NRCT applies if non-excluded personnel in New Zealand are involved. A special rate or an exemption might be available, if DTA relief applies. *Royalties* See transaction 3: Licensing copyright rights.
2. Sale of copyright rights	**Capital or revenue account transaction** Transfer of ownership of	*Sales on revenue account – New Zealand–sourced income*

	copyright rights, typically for the copyright term and a single payment. Capital or revenue treatment depends on the circumstances of the sale from the non-resident's perspective.	• If a DTA applies, the income is generally not taxable unless attributable to a PE in New Zealand (subject to the specific wording of the capital gains article (art 13) of the DTA). • If no DTA applies, the income is taxable (eg, from business or contracts under s YD 4(2) or (3)).
3. Licensing copyright rights	**Royalty** The grant of copyright rights for commercial exploitation for a specified term, typically though periodic payments.	*New Zealand–sourced income* • If a DTA applies, New Zealand has limited taxing rights (see withholding tax) unless it is attributable to a PE in New Zealand as business income. • If no DTA applies, income is taxable (eg, from royalties, business, contracts or royalties under s YD 4(2), (3) or (9)). *Withholding tax* • If a DTA applies, non-resident withholding tax (NRWT) at a reduced rate of 5% or 10% applies unless the royalty is attributable to a PE in New Zealand. • If no DTA applies (or a PE exists), NRWT applies at 15%. *Investment income information* • Reporting obligation applies.
4. Sale of copyrighted articles	**Sale of goods** Supply for end-use of a software copy rather than rights to commercially exploit underlying copyright.	*New Zealand–sourced income* • If a DTA applies, income is generally not taxable in New Zealand unless it is attributable to a PE in New Zealand. • If no DTA applies, income is taxable (eg, from business or contracts under s YD 4(2) or (3)).
5. Leasing copyrighted articles.	**Rental** Temporary supply for end-use of a software copy without rights to commercially exploit underlying copyright. **Interest** Lease of copyrighted article where finance lease rules apply.	***Where lease is not a finance lease*** *New Zealand–sourced income* • If a DTA applies, income is generally not taxable in New Zealand unless attributable to a PE in New Zealand. • If no DTA applies, income is taxable (eg, from business or contracts or for use of personal property under s YD 4(2), (3) or (8)). *Withholding tax*

	Royalty Lease of a copyrighted article where the payment is for the use of industrial, commercial or scientific equipment under some DTAs.	• NRCT applies as a supply of the use or right to use personal property in New Zealand. A special rate or an exemption might be available, if DTA relief applies. • NRCT rate is limited if a DTA royalties article applies. *Royalties* See transaction 3: Licensing copyright rights. ***Where lease is a finance lease*** • A portion of the payments is treated as interest income subject to NRWT. • NRWT rate is reduced if a DTA applies. • NRCT does not apply. • RWT may apply instead of NRWT if a fixed establishment is in New Zealand (either instead of or in addition to a PE being in New Zealand).
6. Supply of know-how	**Royalty** Supply of confidential commercial, industrial or scientific information provided under confidentiality restrictions.	See transaction 3: Licensing copyright rights
7. Development, modification and other services	**Services** Supply of services performed by the non-resident using its knowledge or expertise. **Royalty** Supply of services where the payment is for assistance enabling application or use of something that gives rise to royalties: s CC 9(2)(h).	*New Zealand–sourced income* • If a DTA applies, the income is generally not taxable unless attributable to a PE in New Zealand. • If no DTA applies, the income is taxable (eg, from business or contracts or for use of personal property under s YD 4(2),(3) or (8)). *Withholding tax* • NRCT applies where services are rendered in New Zealand. A special rate or an exemption might be available if DTA relief applies. *Royalties* • See transaction 3: Licensing copyright rights.