

Ottawa, April 17, 2001

SUBJECT

DETERMINING VALUE FOR DUTY OF COMPUTER SOFTWARE

This Memorandum provides guidelines and examples for determining the value for duty on computer software.

**GUIDELINES AND
GENERAL INFORMATION**

1. Under the *Computer Carrier Media Remission Order*, customs duty is not to be assessed on the value of the instructions or data content. However, duty is to be paid only on the value of the carrier medium (for example disk or tape) and the cost of reproducing the information onto the medium.
2. The above-mentioned Remission Order states Canada's position regarding a 1984 decision taken by the General Agreement on Tariffs and Trade (GATT) Committee on Customs Valuation. Signatory countries to the GATT Valuation Agreement have the option to value computer software based on its carrier medium alone.
3. The GATT decision and the Remission Order do not consider the application of the goods and services tax (GST). Therefore, on importation, the GST is payable on the full value for duty of the software package (i.e., disk and program).
4. In most cases, the valuation of computer software will not be difficult. The value for duty of software that has been sold will be determined using the transaction value method. An example of how the transaction value would apply is shown in paragraphs 6 to 13.
5. There are circumstances where the transaction value method may not be appropriate. This can occur when the importation does not result in the sale of the software, or when the software developer retains ownership of the software and charges a licence fee. Paragraphs 14 to 21 provide guidance for determining the value for duty in these cases.

PREPACKAGED SOFTWARE

6. The most common importation results from the sale of off-the-shelf, prepackaged computer software. These importations involve a transfer of ownership with the applicable licence fees usually "bundled" into the selling price.
7. In such cases, the transaction value method applies. The value for duty is based on the price paid or payable for the software in the export sale to Canada.
8. Memorandum D13-4-2, *Customs Valuation: Sold for Export to Canada (Customs Act, Section 48)*, addresses the issue of what is a sale for export.
9. It should be noted that where a sale has occurred, the price paid or payable must be based on the actual price paid and not on price lists from other sources. For example, if a particular software package normally sells for \$200, but here the same package is being sold by, for instance, a discount outlet for \$75, the value should be based on the \$75 sale.

SALE – CUSTOM-MADE SOFTWARE

10. The transaction value method also applies in the sale of custom-made software designed specifically for one or a limited number of purchasers. In this case, the purchaser receives ownership and obtains the right to use the software. The value for duty is based on the price paid or payable for the software in the export sale to Canada.

Note: In cases where custom-made software is supplied by way of lease or licence, refer to paragraph 21.

SALE – ROYALTIES OR LICENCE FEES

11. As with other products, royalties or licence fee payments on computer software sometimes occur above the price paid/payable. If this is the case, the importation is subject to the adjustments identified in subsection 48(5) of the *Customs Act*. Licence fee payments must be included in the transaction value if they are “in respect of” the software and are a condition of the sale of the software.

12. For further information on the treatment of royalties and licence fees when goods are the subject of a sale, see Memorandum D13-4-9, *Royalties and Licence Fees (Customs Act, Section 48)*.

UPDATE DISKS

Charge for Updates

13. The transaction value method will continue to apply if the importation of update disks is a result of a sale. For example, the vendor charges the purchaser \$1,000 for the original software package and charges \$100 for each update disk. The value for duty of each update disk is \$100 subject to the adjustments identified in section 48 of the *Customs Act*.

Free Updates – Original Package

14. Update disks may also be provided to the purchaser free of charge under the original terms of sale or licence agreement. Therefore, the value of the update disk has been included in the value of the original package. If such an arrangement can be shown to exist, the value of the update disk will be zero for customs and GST purposes.

15. For example, the vendor charges the purchaser \$1,000 for the original software package. The terms of sale or licence agreement are such that the \$1,000 price includes update disks to be provided to the purchaser. The value for duty of the original package is based, under the transaction value method, on the price paid of \$1,000. The value of the update disk is included in the value for duty of the original package.

Free Update – Annual Fee

16. If update disks are supplied free of charge as a result of membership in a club (dues) or the payment of an annual fee, these amounts would form the basis of the value for duty. The total amount (dues or fees) would be applied to the value of the first disk. Additional disks imported during the year would be valued in the same manner as explained in paragraph 14.

PROMOTIONAL COPIES

17. As the importation of promotional disks does not involve a sale, the transaction value method cannot be used.

18. In such cases, based on the principles of the GATT decision on the valuation of computer software, the value of the copy will be determined according to Memorandum D13-11-2, *Value for Duty of Certain Information-Based Products (Customs Act, Sections 48 to 53)*. The value of such software would be based on the value of the physical medium, for example the disk or tape, and the cost of transcribing the information onto the medium.

TEST VERSIONS

19. Test versions of upcoming software releases, sometimes referred to in the industry as beta versions, may be sent to Canada. These importations may occur for quality control or for product evaluation.

20. If the test versions are sold, the transaction value method will be applicable. If they are imported free of charge, the method used in paragraph 18 would apply. In other words, the value for duty will be based on the value of the physical medium, that is, the disk or tape, and the cost of transcribing the information onto the medium.

NO SALE LICENSED SOFTWARE

21. Copies of computer software, usually custom-designed, may be provided under a licence agreement for an initial "up front" charge with an ongoing fee for use. In such cases, ownership and control of the software may not be transferred to the receiving party. In other words, there is no sale. In most of these cases, a licence or lease fee is paid to the owner for the right to use the software for an agreed period. The transaction value method may not be used in this situation as there is no transfer of ownership and a sale has not occurred.

22. Subsequent methods of valuation also prove elusive. It is not likely that there are sales of identical or similar goods to Canada. A deductive value cannot be determined without a sale of the goods, or identical or similar goods, in Canada. The absence of sales to Canada also affects the ability to determine a profit and general expense figure under the computed value method.

23. Therefore, the Canada Customs Revenue Agency (CCRA) will continue to abide by the principles of the GATT decision on carrier media-bearing software, as well as the principles embodied in Memorandum D8-3-15, *Computer Carrier Media Remission Order*, and Memorandum D13-11-2). Since December 1, 1994, the valuation of licensed or leased software for which a sale does not exist will be based on the acquisition cost of the carrier medium and the cost of transferring the information to the medium.

24. While GST is payable only on the medium value at the time of importation in the foregoing circumstances, it is possible that GST may be payable on the licence fees according to other provisions of the GST legislation. Excise Technical Information Bulletin B-037R, *Imported Computer Software*, addresses this issue. The CCRA district excise/GST office may also be contacted regarding information on the taxable status of such fees.

Application of the Harmonized Sales Tax (HST) on Imported Goods

25. The federal government and the provincial governments of Nova Scotia, New Brunswick, and Newfoundland reached an agreement on the harmonized sales tax (HST) system and implemented the HST on April 1, 1997. The HST applies at a single rate of 15% to imported casual goods destined for consumption in the participating provinces. Casual goods are defined as goods not for sale or for any commercial, industrial, occupational, institutional, or like use. The rules governing the operation of this tax are the same as for the GST. Accordingly, the HST is applied to all goods that are currently subject to the GST. Goods that are currently zero-rated or exempt from GST under the federal legislation are also zero-rated or exempt from the HST.

26. In the case of imported commercial goods, only the 7% GST, as currently required, is payable at time of importation. The remaining 8% provincial portion is payable through the self-assessment provisions of the legislation.

Note: For those provinces not participating in the HST, but that have reached agreements for their applicable provincial sales tax (PST) to be collected by the CCRA, the same conditions apply as indicated above for the HST.

27. For further information, contact the Origin and Policy Valuation Division, Trade Policy and Interpretation Directorate, at (613) 941-4779.

28. For GST assistance, call your local CCRA district excise/GST office.

REFERENCES

ISSUING OFFICE –

Origin and Valuation Policy Division
Trade Policy and Interpretation Directorate

LEGISLATIVE REFERENCES –

Customs Act, sections 48 to 53

HEADQUARTERS FILE –

7034-5-38

SUPERSEDED MEMORANDA “D” –

D13-11-6, July 2, 1997

OTHER REFERENCES –

D8-3-15, D13-11-2

Services provided by the Canada Customs and Revenue Agency are available in both official languages.

This Memorandum is issued under the authority of the Commissioner of Customs and Revenue.