



EXPORTING SOFTWARE

Successfully exporting software requires consideration of the type of software, end-use, intellectual property security, export regulations, the destination country, and delivery. For the exporter, selling a PC or even a word processing program to a foreign customer could have serious consequences if there is not a comprehensive and routine export control procedure in place. Exporters will benefit by developing a detailed export plan of action.

TYPES OF SOFTWARE

Packaged software (also known as Mass Market software) is generally available to the public and is sold from retail stock or mail order. It is installed by the consumer and additional technical support is minimal. Customized software differs considerably from packaged software because it is designed or modified for a specific end-user and frequently installed by the vendor, who may provide extensive technical support. Customized software tends to be higher in value than packaged software. Software as a Service (SAAS) is proprietary software that is hosted by the seller. Since it is typically installed on the seller's server, the enduser accesses the software over the internet on a pay-for-use basis. SAAS has advantages in that the software does not need to be installed on multiple computers, multiple enduser licenses are not needed, and updates such as patches can be performed by the host without the enduser having to download anything.

REGULATORY DEFINITIONS

The two main federal government agencies that oversee regulation of software exports in this country are the United States Department of Commerce and the U.S. State Department. For the purposes of export control, the United States Federal Government defines software in broad, general terms. The U.S. Department of Commerce's Export Administration Regulations (EAR), for example, refer to software as a "collection of programs" and "a sequence of instructions to carry out a process in, or convertible into, a form executable by an electronic computer". The State Department's International Traffic in Arms Regulations (ITAR) also defines software broadly, "to include, but not limited to, the system functional design, logic flow, algorithms, application programs, operating systems and support software for design, implementation, test, operation, diagnosis, and repair". ITAR-controlled software includes 4 categories:

1. Military information and security systems and equipment, including cryptographic devices, software, and components designed and modified for that purpose;
2. Instrumentation and navigation systems, equipment and software;
3. Range instrumentation radars and associated optical/infrared trackers and software;
4. Software that records and processes flight data, enabling determination of vehicle position during its flight plan.

SHIPPING CONSIDERATIONS

Export regulations require an Electronic Export Information (EEI) filing for shipments over \$2,500 per Schedule B Number. This is one reason many shipments of packaged software are typically not recorded by the U.S. Census Bureau. In fact, export regulations only require that the value of the "medium" -i.e., the cost of the disk, tape, or drive- must be reported. This implies that the true commercial value of software exports and imports is not fully captured.



EXPORTING SOFTWARE

Express Package Delivery: Package carriers like UPS and FedEx are typically used to ship low volumes of packaged software on a medium (CD, thumbdrive, etc.), and have systems for clearing exports through certain Customs procedures. International software shipments always require a commercial invoice and possibly an EEI.

Electronic Software Delivery: In addition to immediate delivery, “shipping” (downloading) software via the Internet offers tax and tariff advantages. When software is delivered electronically, it is considered an “intangible” export, which does not have a corresponding Schedule B code, meaning import tariffs cannot be assessed by foreign Customs (although there still may be other taxes and duties levied). Intangible exports of software also do not require an EEI, even if an export license is required. This is the case, for example, for software demos and updates. Since a software demo has no commercial value, an EEI is not required. It is worth pointing out, however, that some countries impose a restriction on the complexity of the demo and the amount of time a demo product can remain in their country. Software updates do not require an EEI for electronic delivery, regardless of value. An EEI is still required if an update is mailed (on a disc, etc.) that costs over \$2500.

Tariffs and Taxes: The specific country in which your buyer is importing the software will decide the tariff or value-added taxes involved. In order for U.S. and foreign Customs officials to assess duty correctly, the value of the medium should be indicated separately from the value of the intellectual property on the commercial invoice. Some countries, like China, assess duties (tariffs) based on the value of the medium, but assess taxes (VAT, etc.) based on the value of the intellectual property value of the software. Software that includes sound, cinematic or video recordings, game software, etc., may be subject to a separate valuation policy. India, for example, differentiates entertainment and telecom software differently from other types of software.

If the buyer country’s tax rules treat the payments from the license as “royalties” and they subject royalties to a withholding tax, the foreign buyer will have to withhold (and pay to the foreign government) the percentage of the payment due under the license agreement. On the other hand, if the foreign country’s tax rules treat the software licensing payment as sales or regular business income, the payment typically will not be subject to a withholding tax. The U.S. company may owe income tax to the foreign country on the payment if the company has a “permanent establishment” or is otherwise treated as engaging in business in the host country.

The U.S. has **bilateral tax treaties** with more than 50 countries. These tax treaties generally offer lower withholding tax rates.

(Source: ITA Office of Technology and Electronic Commerce)

The **Information Technology Agreement (ITA)** is an international trade agreement that requires participating countries to eliminate tariffs on a specific list of IT products. These products include computer hardware and peripherals, telecommunications equipment, computer software, semiconductor manufacturing equipment, analytical instruments, semiconductors and other electronic components. The agreement includes 70 countries and covers approximately 97 percent of world trade in IT products.



EXPORTING SOFTWARE

| Tariffs and Taxes on U.S. Exports of Computer Hardware and Software (on a medium) | | | | | | |
|---|-----------------------------|-----------------------------|---------------------------------|-------------------|--|--|
| Country | Computer Hardware (HS 8471) | Computer Parts (HS 8473.30) | Computer Software (HS 8524) | Manuals (HS 4901) | Withholding Taxes on Software | Other Taxes |
| BRAZIL | 1.5-26% | 1.5-23% | 17.5%(M) | 0% | 25% on interest and royalties paid to non-residents 15% on international money transfers on software purchases | 1% misc. taxes on CIF; ICMS (Merchandise Circulation Tax) tax on CIF + duty + abovementioned misc. taxes; merchant marine tax 25% ocean freight charges; 2.2% syndicate fee; 1% warehouse tax; 3% port tax; Industrial Products Tax (IPI) on CIF: 15% on hardware, 0-15% on software, 3.5% on capital goods. |
| CANADA | 0% | 0% | 0% | 0% | Exempt | 7% goods and services tax (GST) assessed on total value of shipment; provincial sales tax (PST, decided by individual province), if applicable |
| MEXICO | 0-23% non NAFTA; NAFTA 0% | 0% | 13-18%(C) - non NAFTA; NAFTA 0% | 0-20% | 10% | 15% VAT on FOB value + duty; approximately \$13 Customs processing fee - not charged on NAFTA imports |

(Source: Brazilian, Mexican, Canadian Customs)

RESTRICTIONS, REGULATIONS, AND COMPLIANCE

Export controls are meant to promote national security, support foreign policy, and carry out international obligations. The U.S. Departments of State, Treasury, and Commerce each have their own lists of denied parties, and maintain independent systems of export controls. The intention of the federal government is not to hinder international trade, but to control sales of software and other information products that may be used against U.S. national interests.

[See VEDP Fast Facts on "Export Licensing, Regulations, and Compliance"](#)

The need for an export license to sell software to a foreign buyer is determined by the specific application of the software, the buyer's country, and the level of software encryption. Like all U.S. exports, some destinations will require a license regardless of the product's application or encryption level, and some countries are off-limits altogether. U.S. exports of most goods and services to Cuba, Iran, North Korea, Sudan, and Syria are prohibited or require an export license or special exemption.

U.S. exports that use encryption technology may require an export license from the Department of Commerce's Bureau of Industry and Security (BIS). If this is the case, you will likely need to determine your product's Export Control Classification Number (ECCN), which indicates a product's level of regulation.

Mass market encryption commodities and software employing a key length greater than 64 bits for the symmetric algorithm remain subject to the U.S. Department of Commerce's Export Administration Regulations (EAR), and require review by BIS under the mass market provisions of



EXPORTING SOFTWARE

Section 742.15 (b)(2) of the EAR. This is also true for Information security software (data confidentiality encryption less than or equal to 64-bits in key space or data authentication encryption). Items not elsewhere specified on the Commerce Control List (CCL) are classified as EAR99 NLR (No License Required).

If you are exporting software that is closely regulated, it is advisable to establish a procedure that requires your buyers to sign an “Export Control Certification Statement”. This is especially true if you are selling software electronically over the internet. The statement would have your buyer acknowledge that your product is subject to U.S. export control regulations. An example of such a statement might read as follows:

“ABC Software uses encryption technology which makes it subject to export control under the U.S. Export Administration Regulations. Federal law prohibits the distributing, exporting, or re-exporting of this software to anyone who is a citizen or resident of prohibited countries or who is, or controlled by, someone on any list of Denied Persons issued by the U.S. Departments of State, Treasury, or Commerce. The underlying technology cannot be used for the design or development of nuclear, chemical, or biological weapons or missile technology without prior permission by the U.S. Government. Residents in the importing country may be subject to home country restrictions on receipt, distribution, and downloading of this software as well.”

PROTECTING INTELLECTUAL PROPERTY

- Software is protected if it meets other patentable criteria. If your software “does something in the real world” which is not easily clarified, then you can patent “how it does it”.
- Copyright your software in countries where copyright infringement is commonplace (like China).
- Have agreements with your partners to protect trade secrets. Naturally, you should avoid exposing the source code of your software.
- Report to the appropriate authorities any violations you find on software products, even though the results may be slow.
- Get a qualified attorney with expertise in software and international intellectual property protection!

See VEDP Fast Facts on “Intellectual Property Rights”.

(Source: Brown and Michaels)

RECLASSIFICATION OF CERTAIN U.S. SOFTWARE EXPORTS

The Schedule B Numbers for electronic media underwent significant revisions in 2007. Considering recent advances in technology, the U.S. Census changed some Schedule B codes and eliminated others. There are now several new Schedule B numbers relevant to software, including 8523.40.2010 (*Prepackaged software for automatic data processing machines, of a kind sold at retail*) and 8523.40.2020 (*Other software*), which would encompass unpackaged, customized software, for example. Exporters need to be aware of these changes in Schedule B codes and may need to advise their customers on changes which may affect their harmonized codes for importing.



EXPORTING SOFTWARE

VEDP SERVICES

The VEDP offers a number of export-related services to Virginia businesses, including group market visits and market research by our Global Network of in-country consultants. These services are available to all Virginia exporters. For more information, please visit our website: www.exportvirginia.org.

ADDITIONAL RESOURCES

- U.S. State Department. Directorate of Defense Trade Controls: <http://pmdrtc.state.gov>
- U.S. Commerce Department. Bureau of Industry and Security. "ECCN. Questions and Answers": http://www.bis.doc.gov/licensing/doing_business_with_eccn.html
- Business Software Alliance: www.bsa.org
- Software Terms to Avoid Using in Commerce: <http://www.gnu.org/philosophy/words-to-avoid.html>
- Information Technology Association of America: <http://www.ita.org>
- Microsoft- Exporting Basics: <http://www.microsoft.com/exporting>
- National Association of Software and Service Companies: www.nasscom.org
- Software and Information Industry Association: <http://www.siaa.net>
- World Information Technology and Services Alliance: <http://www.witsa.org>

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