WITHHOLDING TAX AND PAYMENTS TO AUTHORS

Adrian Shipwright[1]

Introduction

The UK withholding tax on payments to authors, particularly to those abroad, is somewhat curious and anomalous being based not only on statute but an answer to a question in the House of Commons in 1969.[2] The position can be further complicated because often a literary agent will be involved, so aggravating the problems of a particularly difficult area of tax law. The payments made to authors can consist of royalties, advances on account of royalties, minimum guarantees and lump sums.[3]

The simple sounding question whether or not someone by or through whom payments in respect of copyrights are made (such as a literary agent[4]) should withhold UK income tax raises difficult points of analysis of the source of the income and its derivation. This in turn raises questions of what is copyright for these purposes, which in turn has implications for the drafting of documents. It is with these matters that this article is concerned.

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2 See Shipwright & Price, *UK Tax & Intellectual Property* (ESC) passim, but in particular Chapter 10.

3 [1986] EIPR 48.

4 The literary agent will usually receive and/or collect royalties, etc., and account for them to the client net of its fees. The literary agent may have to deduct basic rate income tax but only from the amount net of fees; see s.536(3) TA.

Further complications can arise where payments are made in a chain. These matters are not "merely academic" as failure to deduct income tax is treated as a mistake of law and not fact, with the result that the amount not deducted cannot be recovered from the recipient at law without some additional contractual or other right.[5]

Copyrights, Persons and Payments

Copyright is something that relates to a particular jurisdiction and has its validity by reference to that law. In this respect it resembles tax. Copyright arises usually in relation to a particular country's legislation. Thus a work may be protected in France under French law as a French copyright and under Australian law as an Australian copyright, but not as a French copyright in Australia or vice versa. There are a number of International Conventions and Agreements concerning copyright.[6] However, the broad effect of these treaties is to give protection in a different signatory state under that state's law and to the extent that that state gives protection as if the work in question had complied with the formalities for copyright protection in the state in question if it had complied with the requirements in the home state. In other words, quintessentially the Conventions "secure the principle of national treatment".[7] Consequently, the location of the source of income for income taxation purposes varies with the country of the particular copyright in question. This is an important matter to be borne in mind when drafting documents. A copyright is usually regarded as situate where it is registered (insofar as this is relevant) or enforceable.[8] Consequently, there can be different sources and the draftsman should consider splitting the sources to maximise cashflow and receipts.

The works and matters protected by copyright are international and have economic value outside their country of origin. Equally the persons who own copyrights or have licences granted to them can be quite diverse (inter alia) as to type, location and use.

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5 see, e.g., *Shaw v Bernard & Shaw* (1951) 30 ATC 187, *A-G v Jeanne Antoine* (1949) TC 213 and the recent Law Commission Report on payment under mistake.

6 e.g., The Berne Convention and its revisions at Berlin, Stockholm and Paris, and the Universal Copyright Convention.

7 Cornish, page 335.

8 cf, s.18(hb) CGTA inserted by s.303 and Schedule 7 Copyright, Designs and Patents Act 1988.

Consequently, the persons to whom payments relating to copyrights are to be made can include:

a UK resident copyright owners;
b Non-UK copyright owners;
c Personal representatives of authors;
d Assignees of authors and owners.

These payments may relate to UK and/or non-UK copyrights with the effects on the source mentioned above.

The UK Withholding Requirement and UK Tax

1 General

The provision requiring withholding in some circumstances is to be found in s.536 TA. This imposes an obligation to deduct UK basic rate income tax where "any payment of or on account of any royalties or sums paid periodically for or in respect of ... copyright" is made to the owner of the copyright where that person's "usual place of abode" is not within the UK. The s.349 TA procedures[9] are to apply for deduction and accounting to the Inland Revenue. Accordingly, payments to a person whose usual place of abode is in the UK do not suffer withholding under this provision and the payer should not deduct tax. The section does not impose liability to tax, it merely provides machinery for its collection.[10] Accordingly, since by definition a non-resident is involved where s.536 TA is in question there must be a UK source for UK income tax to apply. Hence the importance of the situs of the source and its identification.[11]

S.536 TA raises a number of definitional questions including the following:

a. What is a person's usual place of abode? Where is it in any particular case?

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9 i.e., deduction of basic rate income tax and accounting to the Inland Revenue are compulsory. S.536(3) & (4) allows deduction from the amount net of agent's fees and the payment is treated as being made when it is paid by the first person in a chain. The rate of tax is therefore to be the rate at that time and not a different rate if a change occurs before a subsequent payment. Deduction by the first payer in practice "franks" subsequent payments so that only one "bite" of income tax is taken. It is hard to provide unequivocal authority for this. A company is to account quarterly; see s.349 TA and Schedule 16.

10 see *Rye & Eyre v IRC* below.

11 *Colquhoun v Brooks* infra, *Becker v Wright* infra, *National Bank of Greece Case* (1970) 46 TC 472.

b. What is meant by copyright for these purposes? Is it limited to UK copyright?

c. When is a payment for or in respect of copyright?

d. What are royalties or sums paid periodically?

2 Usual Place of Abode

This raises the question as to what is meant by the phrase "usual place of abode". It seems there is no definitive answer to this but in practice it is usual taken to be equivalent to residence.[12] It is an important matter for a payer to discover as it affects whether or not the payer can be assessed for the tax and consideration should be given to dealing with the point in documentation.

3 Copyright - UK or Foreign

The question also arises as to what is meant by "copyright" for this purpose. S.536(2) TA tells us that copyright for these purposes excludes copyright in cinematograph films, video recordings and their relative soundtracks so far as not separately exploited. This reflects the common Double Tax Treaty approach that film receipts are to be treated as business receipts. The owner of a copyright includes a person entitled to receive periodical payments in respect of a copyright notwithstanding that the copyright has been assigned. As the owner of the copyright is abroad by definition where s.536 TA applies, for a liability to UK income taxation to arise there must be a UK source. The 1969 statement[13] and *Rye & Eyre v IRC*[14] seem to support this. Lord Hanworth MR said in *Rye & Eyre v IRC*:

> "In the present case the property that we have to deal with, the property from which this income arises, is definitely property in this country. It is copyright and that is property which is secured by the laws of this country to the owner of the copyright wherever he happens to be resident. In this case he was resident abroad, and the income was payable to him in respect of that property which the laws of this country gave to him."

The better view seems to be that payments received by professional authors derive from their profession and not from the copyright[15] so that s.536 TA would not apply. As UK tax has a territorial limitation there must be a UK source for UK income tax to apply and so s.536 TA only seems applicable to payments in respect of UK

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12 cf, *R v Bundy* [1977] 2 All ER 382. It has been said usually to be a question of fact rather than law (*Courtis v Blight* (1862) 31 LJCP 48).

13 set out below (10th Nov 1969, HC Vol 791, Col 31).

14 19 TC 164 & Lord Hanworth at p.170.

15 see, e.g., *Billam v Griffith* (1941) 23 TC 757, *Cheney* infra, *Stainer* infra and the 1969 Statement.

copyrights.[16]

4 Periodic Payment for Copyright

It seems that capital payments would not fall within this phrase.[17] The matter has been relevant in a number of cases some of which are considered here.

In *IRC v Longmans Green & Co* (1932) 17 TC 272 the question at issue was whether payments should be made under deduction of tax which related to the transfer to English publishers of the English rights to "Le Silence de M. Clemenceau". The book was not to be published till after M. Clemenceau's death. The agreement provided for a lump sum of FF500,000 to be paid for the right to sell 28,000 copies.

Finlay J approached the problem by considering whether there was an outright sale or an assignment or only a licence. He thought the point was not free from difficulty, saying that " ... between a partial assignment of copyright and a licence the line may run extremely fine."

The next point to consider according to the learned judge was what the sum of FF500,000 was for? Was it or was it not a royalty? On the correct construction of the document he concluded it was an advance against royalties because of the way in which it had been calculated, which was on the basis of 2/9d a book. Consequently, the payments were to be made under deduction of tax.[18] *Howson v Monsell* (1950) 31 TC 529 concerned an assessment on Mr Monsell in respect of sums received by his wife who wrote books under the name of "Margaret Irwin" in respect of sums paid for the film rights to "The Gay Galliard" and "Young Bess". Payments were made for the rights of £5,000 and $75,000 respectively. The sums were paid in instalments over a number of years. The General Commissioners decided that the sums were of a capital nature and so not chargeable under Case II of Schedule D.

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16 see, e.g., *Colquhoun v Brooks* (1889) 2 TC 490 and *Becker v Wright* (1965) 42 TC 591.

17 Unless they amounted to royalties. On capital and income, see Shipwright and Price, op.cit., Chapter 4.

18 cf *Rye and Eyre v IRC* (1935) 19 TC 164 and *Household v Grimshaw* (1953) 34 TC 366.

Danckwerts J reversed the Commissioners, deciding that the sums were properly chargeable under Case II of Schedule D.

He said:

> "... it is plain that Mrs Monsell received these sums by reason of the fact that she was carrying on the vocation of writer or authoress of historical books and that the receipt by her was plainly in the course of carrying on that vocation."

In *MacKenzie v Arnold* (1952) 33 TC 363 Danckwerts J said that:

> "there has been a considerable body of authority upon the position of authors, who, like painters of pictures suffer tax on what, on a superficial view, might be supposed to be the sale of the capital asset as when the copyright of a book, or a picture produced by a painter, is sold. It is settled now beyond contest, though there appears to be some hardship in the author having to pay tax upon what is the price paid for the sale of the copyright, that that is a receipt and a profit obtained by the author in the course of the practice of his profession."[19]

This was upheld by the Court of Appeal.

Care is therefore needed in planning and drafting in this area.

The Parliamentary Statement

Roy Jenkins said the following in response to Mr Ashton's question as to "what steps he takes to recover tax on fees paid to British nationals living abroad by publishers in this country?":

> "[S.536 TA 1988] requires any person making such payments to deduct income tax at the basic rate and to pay it over to the Inland Revenue. I am advised that this does not apply to payments made to those who are authors by profession nor does it apply if the recipient is living in a country with whom we have a double tax arrangement requiring us to exempt such payments."

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[19] cf, *Nethersole v Withers* (1948) 28 TC 501.

A ministerial statement is not law. The practical problem is "How far as a matter of law can it be relied on?" This raises nice points of constitutional and administrative law and problems of estoppel against the Crown.[20]

In practice it seems that a long standing statement of this sort is usually applied by the Inland Revenue. It also seems to be correct as a matter of law. It supports the view that the source of income for a professional author is the profession not the copyright. This analysis would seem to apply to both UK and foreign copyrights although it is understood that this is not the Inland Revenue's view in practice.

UK Resident Copyright Owners

S.536 TA imposes no obligation to withhold basic rate income tax unless the owner of the copyright is resident abroad. Consequently, there is no UK withholding requirement where payments relating to copyright are made to persons who are resident in the UK. This is so whether the payment is made to the original practising author, an assignee of the author, a retired professional author or the author's estate (including assignees) provided the recipient is UK resident.

Non-UK Copyright Owners

The source of the payment has to be analysed in these circumstances. Where a professional author is concerned the question arises whether the source of the payment is the profession or the copyright. If the source of the payment is the profession then where a non-resident professional is involved the situs of the source is non-UK. Finlay J said of the section that:

> "... it is an alteration and improvement of machinery of the collection of the tax and it is an alteration and improvement of machinery and nothing else. It does not ... increase the ambit of the tax."[21]

Post-cessation receipts (e.g., royalties received by authors who have ceased writing) are outside the charge to income tax on general principles, as was decided in *Carson v Cheyney's Executors*.[22] A charge under Schedule D Case VI may arise under ss.103 and 104 TA. However, these sections only apply to Cases I and II. In the circumstances under consideration here it is likely that any charge should be under Schedule D Case V so that the conditions for the application of the statutory provisions would not apply. If so, s.536 TA should not be applicable. However, it is believed that the Inland Revenue do not share this view. They might seek to argue that the copyright had become the source on cessation. This would only require deduction at source from UK copyright payments.

Personal Representatives of Authors

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20 see Shipwright K.C.L.J. 2 (1991-2) at page 97 et seq.

21 *Rye & Eyre v IRC* (1934) 19 TC 164 at 168.

22 (1957) 38 TC 240.

In relation to non-UK copyright, payments should be made gross.

The position of UK copyright is more complicated as it seems hard to show that the source of the payment is something other than the copyright itself.

Carson v Cheyney and *Purchase v Stainer*[23] would suggest that no charge should arise in these circumstances on the basis of a change of character of the source. This is a difficult area and in many cases the practical difficulty relating to deduction will be solved by a double tax treaty.

Assignees of Authors and Owners

Where payments are made to assignees who are non-resident no obligation to deduct arises in respect of payments relating to non-UK copyright. Payments in respect of UK copyright, though, should be made under deduction of tax as the copyright would appear to be the source and not the profession. There may be an argument based on *Noddy Subsidiary Rights*[24] that these are trading receipts and so outside the section but it seems a difficult argument to run successfully.

Conclusion

The deduction of tax in this context is a complex matter which does not always admit of easy answers. However, it is suggested that authority and/or support can be found for the following propositions:

a. payments to a UK resident in respect of UK and other copyrights should not be made under deduction of UK basic rate tax (i.e., should generally be made gross for UK tax purposes).

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[23] (1951) 32 TC 367.

[24] (1966) 43 TC 458.

b. payments to a non-UK resident author should be made gross in respect of non-UK copyrights as the source is outside the UK, and arguably in respect of UK copyrights on the basis that the source is the profession not the copyright.

c. the source where a non-resident UK author is concerned is, according to the better view, the profession and not the copyright.

d. post-cessation receipts are payable gross insofar as they relate to non-UK copyrights and arguably insofar as UK copyrights are concerned. A double tax treaty will often solve the practical difficulty.

e. the drafting of documents should do the utmost to improve the cashflow and overall receipts position and the draftsman should bear the point made above in mind. In most cases it will be sensible to make specific apportionment of payments relating to UK copyright and those relating to non-UK copyright especially where minimum guarantees and non-returnable but recoupable advances are made. Otherwise problems can arise as to how much should be deducted, which may lead to a requirement to deduct larger sums and so to difficulties with the client.