US solidifies software-import rules

Galen Gruman, Soft News Editor

In a preliminary ruling involving claims that the Singapore government subsidized a CASE system imported into the US, the US Commerce Dept. has set the framework for an explicit policy on handling software imports.

Software has existed in gray areas in several legal areas like copyright, patents, and customs because it is intellectual property whose expression is strongly tied to physical devices or utilitarian functions. Most intellectual property has little utilitarian connection, and laws treat intellectual and utilitarian properties differently.

While a final determination is expected later this month, the preliminary ruling issued Jan. 9 outlines Commerce Dept. policy and its underlying rationale for treating software imports. The ruling took the unusual step of explaining its decision in the broad context of US trade and intellectual-property as they relate to software, seeking to establish a common rationale.

"The determination is significant because it does indicate that we will consider software to be subject to our countervailing duty law," said Eric Garfinkel, assistant secretary of commerce for import administration. Countervailing duties are taxes levied against imports that the US believes have been unfairly subsidized. Including software as subject to such duties is "new," he said.

Case specifics. The Commerce Dept. began its inquiry in September after Visible Systems, a CASE manufacturer based in Waltham, Mass., alleged that the Picture-Oriented Software Engineering analysis and design tool had been subsidized by Singapore's National Computer Board, thus artificially lowering the price POSE sold for in the US. POSE is marketed in the US by Computer Systems Advisors Research, a subsidiary of the Singaporean firm Computer Systems Advisors. The Singapore National Computer Board's Information Technology Institute developed POSE and then contracted with CSA to market it internationally as part of an effort to promote local software firms.

The Commerce Dept. investigation examined 18 areas of potentially unfair subsidies. Its preliminary ruling found that CSA received only one type of subsidy: The royalty rate it agreed to pay to the Information Technology Institute was 15.25-percent less than the institute's costs in developing POSE and the expected costs in maintaining it. That difference amounted to a government subsidy of CSA, the Commerce Dept. found.

The Commerce Dept. has defined a policy that will apply to all software importers, regardless of the Singapore case's final outcome.

However, the determination was based on what the Commerce Dept. acknowledged was incomplete information and could be reversed. Singapore will provide to the best of its ability the information needed by the Commerce Dept., said Cecelia Khoo, first secretary for economics in Singapore's embassy in Washington, D.C. The Commerce Dept. seeks details on the bids from CSA and other firms for the rights to POSE to see what type of return the Information Technology Institute sought for its investment in POSE.

The institute had rejected an initial bid from CSA because the royalties were too low, Khoo said. She did not know the details of the second, accepted bid but said that the institute's "intention is to get more back than invested."

The Commerce Dept. ruled that there was no evidence of Visible Systems' other allegation that the Singapore government paid for a CSA employee's salary.

The department also ruled that CSA used none of 16 potential subsidies, like tax breaks and investment allowances, available to Singaporean technology firms from the Singapore government.

Based on its findings, the Commerce Dept. ordered that CSA pay a bond of $42,892 to continue importing POSE until a final decision is reached.

When is software merchandise? "One of the fundamental issues before the department has been whether software on a carrier medium [like a disk or tape] can be treated as merchandise subject to the countervailing duty law," the ruling said. This involves two basic questions:

- Whether packaged software is intellectual property not subject to import duties or dutiable tangible merchandise.
- If dutiable, whether the value against which the duty is levied is equal to the cost of the medium or to some other price.

The Commerce Dept. ruled that while "instructions are intangible when in the mind of the programmer, the embodiment of those instructions, however, transforms the ideas into tangible merchandise."

The department was careful to differentiate between "software on a carrier medium" from software transmitted electronically or used in a service. "Software itself is not dutiable," Garfinkel said, but software fixed to a medium like a disk or tape is dutiable and is thus subject to unfair-trade penalties like countervailing duties.

Software — whether packaged elsewhere and then imported or imported and then packaged — for commercial distribution is merchandise subject to customs duties, the Commerce Dept. ruled. It reasoned that packaged software is no different than books or sound recordings, which have always been treated as merchandise because, although based on intellectual property, they are fixed instantiations of the idea packaged, inventoried, and sold like other merchandise.

This denied Singapore's claim that the

imported disks were not subject to duties because they were not the final, packaged software. "The master disk used for the production of the final prepackaged merchandise is imported, in fact, from Singapore," the ruling said.

Electronic transmissions — like fax, phone calls, and electronic bulletin boards — are excluded from merchandise duties under US law. Also excluded are internal business documents and data. The ruling said that software imported with the intent of copying it for commercial distribution does not qualify as internal business data.

If you transmit software to the US electronically for eventual distribution as packaged software, the resulting software would not be considered an import, the Commerce Dept.'s Garfinkel said. The same is true for books and other intellectual property. Because there is no way to monitor incoming transmissions and decide which may result in products, the US exempts them from customs duties — "they're not reachable," he said.

Treatment standards. Singapore had argued that US treatment of software was inconsistent. The ruling disagreed, saying that it consistently treats software in one of three ways, depending on its form:

- It treats software on a carrier medium as merchandise. This covers software duplicated and packaged, or imported to be packaged, for commercial distribution, such as packaged applications software.
- It treats software in isolation as intellectual property for copyright and other intellectual-property protection.
- It treats software used in business and professional services (like software-development consulting) as an element of the service, not as merchandise. Thus, there would be no duties on a packaged software tool used by a consultant in providing services like writing code and creating designs for a client. (But if the tool were sold to the client, it would then be considered merchandise.) Two ways to distinguish software used in a service from software merchandise are that software merchandise is a written product with broad application that does not need additional servicing by the seller and that it is maintained in inventory by vendors, the ruling advised.

Singapore's position is that "software is software," Khoo said, regardless of medium. She said the distinction between software on a carrier medium and software as an idea is a new distinction in US policy, one going against other nations' assumptions. The Commerce Dept.'s Garfinkel acknowledged that the ruling explicitly applied this distinction to software for the first time but said it was based on the US's historical differentiation between intellectual property (like stories or code) and packaged instantiations (like books or packaged software).