License Code for Software Development

Facts

Mr Smith (Developer) is going to start an IP business in Dubai. He will develop software and sell subscriptions thereto as an application through the Apple Store.

He has no business need to set up a company, as he can operate as a sole establishment. In addition to business reasons, sole proprietorship status is more favorable in terms of Corporate Tax since, in years where revenues don't exceed AED 1 mln, a sole establishment is not subject to this tax but a company is.

To obtain a license in Dubai, the code of activity must be chosen. There are two relevant codes for a developer to consider:

- Code 4741004 "Computer Systems & Communication Equipment Software Trading" includes '*reselling the set of application software and its documentation concerned with realizing the user's needs and problems, and is applicable in different domains, medicine, accounting, and engineering, it involves also the application software designed to run on smartphones and mobile devices*'.

  This code is available to obtain a commercial license, i.e. the type of activity under this code is a "trade". However, it is not available for a sole establishment; only a limited liability company with a single owner (LLC-SO) may obtain a license under this code.

- Code 6201001 "Computer Systems & Communication Equipment Software Design" covers '*firms specialized in computer systems software design, implementation, operation and maintenance based on analyzing the user's problems and his need for economical solution and the programs necessary for realizing such a solution, it involves designing application software designed to run on smartphones and mobile devices*'.

  This code is allowed for a sole establishment. However, the license type for this code is a "service", and a developer receives a professional license rather than a commercial one.

Question

May the developer register as a sole establishment and not as an LLC to develop desktop and smartphone applications for subsequent sale via the Apple store?

In other words, does he need to receive a license only for activity coded 6201001, or is a commercial license for the code 4741004 also required?

Summary

After considering the facts and the analysis below, we opine as follows:

1) The code 4741004 covers reselling. The sale of licenses (subscriptions) for the software which is developed by a licensor is not covered by this code, so a license for activities covered by this code is not required.

2) The code 6201001 doesn't directly mention the sale of developed software. In our view, it doesn't hinder the distribution of developed software via the Apple Store. Therefore, we believe that the developer may set up a sole establishment to develop software and distribute it on the Apple Store.

3) A service (professional) type of license may be used as an argument to counter the above conclusions. In our opinion, this argument is weak, particulary in the cases where:

   a) Software is accessible online rather than downloaded entirely to the user's device, e.g., cloud-based applications, online productivity tools, or services where the core functionality relies on internet access and continuous updates from the provider. Such applications can be classified as based on a "software as a service model" (SaaS), which is a perfect match for a "service" type of license.

   b) Applications require constant connection to the cloud to operate, e.g., cloud storage services, streaming services, or software that relies on cloud-based processing. In these cases, the software serves as a portal to access services hosted on remote servers, fitting the SaaS model.

Analysis

1. The code 6201001 doesn't specifically mention the sale of software or the licensing thereof. However, Mr Smith is not involved in an activity whereby he resells the software, since he hasn't bought the software to resell but has developed it himself to sell. That's why we believe that the code 4741004 doesn't fit his activity.

   ISIC[1] does not define trade but contains definitions of wholesale and retail trade. These are given in Section G, to which code 4741 belongs. Both wholesale trade and retailing include '*the resale (sale without transformation) of new and used goods*. *Most **retailers** take title to the goods they sell, but **some act as agents for a principal** and sell either on consignment or on a commission basis'.* This guides that the agent (Apple), rather than the principal, conducts trade.

2. The code 4741 is a part of Division 47 of ISIC: '*This division includes **the resale** (sale without transformation) of new and used goods. This division also includes the **retail sale by commission agents and activities of retail***

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[1] International Standard Industrial Classification of All Economic Activities (ISIC), Revision 4.

auctioning houses'. So, Apple (agent) conducts activity under the code 4741 rather than the developer (principal) who instructed Apple to do so.

Noteworthy is that '*this division excludes … sale of farmers' products by farmers, see division 01, **manufacture and sale of goods, which is generally classified as manufacturing** in divisions 10–32…'*. Extrapolating this pattern to the case at hand gives the following: the development and subsequent sale of software is classified as development rather than trade. It is excluded from the scope of division 47 "Retail trade, except of motor vehicles and motorcycles".

3. The same conclusion may be deduced from para 134. It sets forth that '*for many production units, e-commerce is just one of a variety of means by which sales are transacted. The rules for the classification of such units in ISIC remain unchanged: **they are classified to the industry of their principal activity.** Increasingly, however, business units that sell goods and supply services exclusively through the Internet are coming into existence. **Such units should also be classified to the industry of their principal activity**. Production units engaged in e-commerce will therefore be found in any industry of ISIC'*.

The same paragraph, though, stipulates that '*there is one notable exception to this rule: **in retail trade**, units that undertake their sales **exclusively or predominantly through the Internet** are classified within ISIC, Rev.4 class 4791 (Retail sale via mail order houses or via Internet)*'. In our opinion, this rule governs the allocation of activity within division 47 "Retail trade". If a retailer has units that conduct retail '*exclusively or predominantly through the Internet'*, he should classify this unit with the specific code 4741 along with other retailing units classified with other codes from division 47. This exception is not applicable to production units, which sell products they have produced.
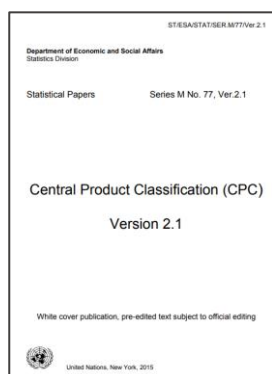
4. ISIC 4 considers coding for '*Outsourcing / activities on a fee or contract basis'* in this way: '*If **only part of the production process** is outsourced, the principal is classified to the class that corresponds to the activity representing the complete production process, **i.e., it is classified as if it were carrying out the complete process, including the contracted work, itself**'* (para 140). As per para 141, '*this applies not only to the outsourcing of support functions in the production process, such as accounting or computing activities, but also to the outsourcing of parts of the core production process, such as parts of a manufacturing process'*. As per para 137(c), '*the production process also includes supporting activities'*. Furthermore, para 139 says: '*contractors, i.e., units carrying out an activity on a fee or contract basis, are usually classified in the same ISIC category as units producing the same goods or services for their own account. Exceptions to this rule exist for trade activities, for which separate categories for such outsourced activities exist'*.

These rules don't smash the above conclusions apart. Such outsourcing rules don't allow the principal to be deprived of its principal activity code just because he has outsourced trade functions to a third party. The outsourcing rules do not instruct one to include the code of outsourced activity in the

description of the activity of the principal. Otherwise, a manufacturing company that has retained, for example, legal or tax consultancy services, would have been obliged to present itself as a legal or tax consultant in the ISIC codes, which doesn't make any sense.

Besides, the outsourcing section is applicable only to the arrangements described in para 136, i.e. to the cases where '*units sell goods or services **under their own name** but the actual production, such as the physical transformation process in the case of manufacturing, is carried out fully or in part by others through specific contractual arrangements*'. This is exactly the opposite of the circumstances of the case at hand where the contractor (Apple) under its own name conducts the sale to the customer.[2]

5. The next stop is para 111 of ISIC 4: '*Many units perform trade and other activities. In such cases, trade turnover figures are the most unsuitable indicators for the unknown value-added share of the trade activity. A much better indicator is the gross margin (**difference between the trade turnover and purchases of goods for resale adjusted by changes in stocks**)*'. Where the developer instructs Apple to sell the software, there is no such margin. The value added share is augmented by the agent (Apple) rather than a developer. This also points to the conclusion that a developer doesn't conduct trade activity.

6. ISIC 4 refers to '*the extended elaboration of services in the Central Product Classification (CPC)*'.

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The latter directly mentions the '*licensing **services** for the right to use computer software and databases*' (code 7331). Since licensing is considered a service, the "service" type of professional license shouldn't hinder software from being licensed to end-users.

CPC also maps its codes with ISIC 4. Code 73311 "Licensing services for the right to use computer software" corresponds to code 5820 "Software publishing" in ISIC4.

Division 58 '*includes … software publishing. Publishing **includes the acquisition of copyrights** to content (information products) and making this content available to the general public by engaging in (or arranging for) the reproduction and distribution of this content in various forms*'.

The Apple Developer Program License Agreement provides for '*terms and conditions that govern membership in the Apple Developer Program*'.[3] Under this agreement a developer becomes a member of the "Program" which '*means the overall Apple development, testing, digital signing, and distribution program contemplated in this Agreement*'. The Agreement allocates functions between the

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[2] As per Art. 1.2(e) of the Paid Applications Agreement (Schedules 2 and 3 of the Apple Developer Program License Agreement) '*in furtherance of Apple's appointment under Section 1.1 of this Schedule 2, You [the Developer] hereby authorize and instruct Apple to … issue invoices for the purchase price payable by End-Users for the Licensed Applications*'
[3] https://developer.apple.com/support/terms/

developer and Apple so that the distribution of the applications developed under the Program falls within the responsibility of Apple. Therefore, Apple's activity falls within the code 5820 "Software publishing" rather than a developer's code. The developer in this Program '*use[s] the Apple Software … to develop one or more Applications …*'.

Licensed Applications are to be delivered by the developer to Apple and shall be made available by Apple for download by end-users. Apple sells applications and delivers them to end-users, collects the price, withholds commission and passes the rest over to the developer.

This is enough to opine that Apple conducts activity under the code 5820 "Software publishing", rather than as a developer. The activity of a developer in this Program is rather limited to those listed under code 6201001 "Computer Systems & Communication Equipment Software Design", which is '*computer systems software design, implementation, operation and maintenance based on analyzing the user's problems and his need for economical solution and the programs necessary for realizing such a solution, it involves designing application software designed to run on smartphones and mobile devices*'.

7. The service and trade types of licensed activity should be specifically addressed to tackle the issue at hand.

We haven't found a clear distinction between a sale of goods and sale of services in UAE legislation in respect of software. The UAE <u>VAT Law</u> gives an unambiguous definition of goods and services where:

- Goods are physical property that can be supplied,

- a Supply of Goods is a '*transfer of ownership of the Goods or the right to use them*', and

- a '*supply of Services shall be every supply that is not considered a supply of Goods*'.

A subscription to software products is definitely a supply of a service under these definitions. However, these definitions apply only to VAT.

8. International practice can be availed to fill the gap in understanding the difference between a sale of services and sale of goods.

8.1. In the U.S., courts have historically grappled with whether software should be treated as a good or a service.

The importance of the distinction is driven by Art. 2 of the <u>US Uniform Commercial Code</u> (UCC). Article 2 '*applies to transactions in goods'*. Therefore, software needs to be a good to fall under the scope of this Article.

Customized software and licenses involving significant services are often classified as services, but an agreement for the transfer of "off-the-rack" software is a transaction in goods.[4]

Michael L. Rustad and Elif Kavusturan[5] depict the '*growing number of anomalies in stretching U.C.C. Article 2 to software licensing*' in a chart as follows:

Attribute	Sales of Goods	Licensing of Software
Sphere of Application	Tangible Goods	Intangible Assets
Transfer of Title	Title passes from the seller to the buyer for the contract price.	Title never passes from the licensor to the licensee.
Ownership	Buyer owns what buyer purchases.	Software licensee may own a physical or digital copy, but the ownership of the underlying intellectual property rights remains with the licensor.
Use Restriction After Contract Formation	Once title passes, typically no location or use restrictions exist in the sale of goods.	A license always imposes restrictions in the use of the software. Software licensors commonly restrict use of the software with clauses prohibiting commercial use, reverse engineering, or that preclude modifications. Licensors impose territorial restrictions and preclude distribution. Location and use restrictions are typically specified in the license agreement.
Confidentiality	The sale of goods presumes no norm of confidentiality.	Licensors do not grant licensee a right to underlying data.
Delivery	The sale of goods is marked by a physical delivery of tangible goods. The buyer has the right to inspect goods.[359]	Software is typically delivered without any tangible media, because it is often "delivered" computer- to-computer without human contact.
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[4] See Gross v. Symantec Corp., No. C 12–00154 CRB (N.D. Cal. July 31, 2012), Olcott Int'l & Co. v. Micro Data Base Sys., Inc., 793 N.E. 2d 1063, 1071 (Ind. Ct. App. 2003), SoftMan Prods. Co. v. Adobe Sys., Inc., 171 F. Supp. 2d 1075, 1084 (C.D. Cal. 2001). Stacy-Ann Elvy, p. 126, 74 Wash. & Lee L. Rev. 77 (2017), p. 126
[5] Michael L. Rustad and Elif Kavusturan, A Commercial Law for Software Contracting, 76 Wash. & Lee L. Rev. 775 (2019), p. 843

Standard of Performance	Buyers of goods have a right to reject goods if the goods "fail in any respect to conform to the contract."	Software is rarely, if ever, "bug-free." With the licensing of intangibles, substantial performance is the *de facto* performance standard.

As this chart demonstrates, Article 2 of UCC technically does not apply to a transaction where a licensor and licensee enter into a license agreement. However, the US Courts apply it. In the absence of a specialized software licensing law, applying Article 2 to software licensing is a legal fiction. The courts have been forced to construct a "white lie" to stretch sales law to the licensing of software because of a lack of specialized legislation.[6]

Thus, US Case Law serves a specific purpose to deal with consumer and other licensees' rights, and in doing so it came up with a fiction equating software with goods. This fiction, though, may not serve as a guide for establishing attributes of goods (or services) in software transactions. Vice versa, a fiction exists to eliminate actual differences. Therefore, the application of the fiction proves that in reality distinctive attributes exist which hinder the direct use of rules for goods in software transactions, as illustrated in the above chart.

8.2. In the European Union, the Software Directive (2009/24/EC)[7] names the process of '*making available for use, for a limited period of time and for profit-making purposes, of a computer program or a copy thereof. This term does not include public lending, which, accordingly, remains outside the scope of this Directive*' as "rental".[8] Recital 29 in the Copyright and Information Society Directive 2001 (2001/29)[9] labels such rentals as 'services by nature'.

COURT OF JUSTICE
OF THE EUROPEAN UNION

The Court of Justice of the European Union (CJEU) in its judgment Case C-410/19 (the Software Incubator Ltd v Computer Associates UK Ltd[10]) dated 16 September 2021, ruled that

'*the concept of 'sale of goods' referred to in Article 1(2) of Directive 86/653 must be interpreted as meaning that it can cover the supply, in return for payment of a fee, of computer software to a customer by electronic means where that supply is accompanied by the grant of a **perpetual licence** to use that software*'.[11] This is substantiated by the consideration that '*the making available of a copy of computer software by means of a download and the conclusion of a user licence agreement for that copy, intended to make the copy usable by the customer, **permanently**, and in return for payment of a*

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[6] Michael L. Rustad and Elif Kavusturan, p. 845
[7] Directive 2009/24/EC of the European Parliament and of the Council of 23 April 2009 on the legal protection of computer programs
[8] Recital (12) in the preamble to Directive 2009/24/EC.
[9] Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the harmonisation of certain aspects of copyright and related rights in the information society.
[10] ECLI:EU:C:2021:742.
[11] Para 51.

fee designed to enable the copyright holder to obtain a remuneration corresponding to the economic value of the copy of the work of which it is the proprietor, **involve the transfer of the right of ownership** *of that copy*'.

Since a temporary end-user subscription doesn't result in a transfer of ownership to the end-user, it should not be treated as a sale of goods.

9. On balance, in our opinion, a commercial license is not required in the scenario at hand. Nevertheless, it makes sense to obtain clarification on this from the Dubai Economy Department.

The disclaimer

This analyse is not based on official clarification from federal or local authorities, and has not been commissioned by them. You should factor this in. The interpretation, conclusions, proposals, surmises, guesswork, etc., the above study comprises have the status of the author's opinion only. Like any human job, it may contain inaccuracies and mistakes that I have tried my best to avoid. If you find any inaccuracies or errors, please let me know so that I can make corrections.

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