E/C.18/2018/CRP.9

Distr.: General
4 October 2018

Original: English

Committee of Experts on International Cooperation in Tax Matters

Geneva, 16-19 October 2018
Item 3 (c) (xi) of the provisional agenda
Taxation of software payments as royalties

Summary

The 2017 update of the Model did not address this issue since the Subcommittee which had been created to study the issue could not reach a decision on the characterisation of software payments as royalties. The previous membership of the Committee recommended further discussion before Article 12 of the Model dealing with royalties could be amended or updated.

The Committee formed a Subgroup within the Subcommittee responsible for the update of the Model to examine the issue of software-related payments as royalties. Mr. Rajat Bansal, the coordinator of the Subgroup, prepared this paper presenting the issue and raised some of the reservations countries have had about the current tax treatment of software payments whether based on the UN Model or the OECD Model Double Taxation Convention.

The paper invites the Committee to discuss the issue for a full understanding of the problem posed by the current definition of royalties in Article 12 of the Model, and to eventually give further guidance to the Subgroup on its work going forward to redefine and extend the term

also invites the Committee to propose other possible issues related to royalties for the Subgroup to study, beyond software payments, for a more complete update of Article 12 of the Model.

Convention. Another aspect from source country taxation point of view is scope of royalties covered by Article 12, in particular with reference to software payments.

5. Paragraph 3 of Article 12 of UN Model reproduces paragraph 2 of Article 12 of OECD under:

s Article means payments of any kind received as a consideration for the use of, or the right to use, any copy

copyright law of many countries. It further suggests that countries which cannot attach software to these categories may use amended version of paragraph 3 referring specifically to software. There are many treaties already including the use of or the right to use software in the definition of royalties or in the protocol elaborating on the definition. There may be a case to include use or the right to use software in the definition of royalties in Article 12.3.

8.2 Distinction between the use of or the right to use software from the use of or the right to use copy-right underlying software and the use of or the right to use a

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OECD view is that not any payment for the use of or the right to use copyright underlying software will constitute royalties. Only the granting of comprehensive rights in the underlying software will be covered by Article 12, and transactions where copyright is transferred to enable the operation of the software are not covered. In the view of OECD, the rights in the copy of programme are considered to comprise too few entitlements to be regarded as full copyright and therefore payments for the rights in the copy of a programme are not automatically royalties. The distinction between the use of copy-right underlying software (royalties) and the use of just enough copy-right to operate the software (no royalties) is not straight forward and impinges adversely on source state taxing rights. The need for this distinction is not necessarily derived from the wording of Article 12(2)(OECD Model) or Article 12(3)(UN Model). Limitation of scope may not be in every

Commentary. One option would be to explicitly include payment for software in Article 12.

8.3 Distribution Intermediaries (Para 14.4 of Commentary):