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**Committee of Experts on International
Cooperation in Tax Matters
Twentieth session**

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Item 3 (b) of the provisional agenda

**Update of the UN Model Double Taxation Convention between Developed and
Developing Countries – Application of Article 12 of the UN Model to software payments**

**Note by the Subcommittee on the UN Model Tax Convention between Developed and
Developing Countries**

Summary

This note provides an update on the work of the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries concerning the application of Article 12 of the UN Model Convention to software payments.

At its twentieth session, the Committee is invited to discuss this note and, in particular, the suggestion included in paragraph 18 of the note.

Background

1. Paragraph 47 of note [E/C.18/2011](#), the report on the Committee's seventh session (Geneva, 24-28 October 2011, when the 2011 update of the UN Model was finalized), indicated that, although changes were made to the Commentary on article 12 (Royalties) as part of the 2011 update, article 12 was not fully considered as part of that update. The paragraph also recorded different views related to these Commentary changes and noted that the article would need to be further discussed:

It was noted that the consideration of article 12 was difficult for the purposes of the update, owing to the fundamental differences in approaches between the United Nations Model Convention and the OECD Model Convention with regard to the taxation of royalties. Nevertheless, article 12 had not been fully considered by the Committee, and it was agreed that it would be included in the catalogue of issues for future discussion. Concern was expressed about the last part of paragraph 11, which limited the relevant scope of information to that arising from previous experience. A new sentence was drafted to reflect the minority view and adopted for inclusion immediately following quoted paragraph 11 of the commentary. A view was also expressed that payments referred to in quoted paragraphs 14, 14.1, 14.2, 14.4, 15, 16, 17.2 and 17.3 might constitute royalties. A new sentence was drafted to acknowledge that view and was adopted for inclusion.

2. At the ninth session of the Committee (Geneva, 21-25 October 2013), which was the first meeting of a new Committee's membership, the Committee recognized the importance of article 12 for developing countries. It agreed that a paper on the topic covering specific relevant aspects, including equipment-related issues as well as issues that could have an impact on technical services provisions, would be prepared for discussion at the following session (paragraph 42 of note [E/C.18/2013/6](#)).

3. When that paper, which outlined the differences between article 12 of the UN Model Convention and the corresponding article of the OECD Model Convention, was discussed at the tenth session of the Committee (Geneva, 27-31 October 2014), the Committee asked the Secretariat to prepare another note with proposed text aimed at clarifying the meaning of the term "industrial, commercial or scientific equipment" in the commentary on article 12, as well as dealing with the issue of coverage or otherwise of software-related payments under the article (paragraphs 50 and 51 of note [E/C.18/2014/6](#)).

4. That note ([E/C.18/2015/CRP.7](#)), as well as another note dealing with Article 12 (note [E/C.18/2015/CRP.6](#)) were discussed at the eleventh session of the Committee (Geneva, 19-23 October 2015; paragraphs 57 and 58 of note [E/C.18/2015/6](#)). As regards the issue of software payments

...it was noted that whereas the OECD Model commentary paragraphs addressing this issue were incorporated into the Model Convention in paragraph 12 of its commentary, the commentary also briefly, and in little detail, recorded the disagreement of some Committee members with the OECD view that payments mentioned in some of the OECD paragraphs were not royalties. It was agreed that there was some uncertainty in guidance on these issues, with which a better articulation might assist.

5. The Committee then decided to set up a Subcommittee on Article 12 (Royalties) with the mandate to

...consider and report on possible improvements to the commentary on article 12 (Royalties) of the Nations Model Convention and, if required, the text of that article. It is mandated to initially report to the Committee at its twelfth session, in 2016, addressing as its initial priority such improvements to the commentary on industrial, commercial and scientific equipment and software-related

payments as are most likely to be accepted by the Committee for inclusion in the next version of the Model Convention.

6. While a note by the Coordinator of that Subcommittee (note [E/C.18/2016/CRP.8](#)) was prepared for discussion and the issue appeared on the provisional agenda for the twelfth session of the Committee (Geneva, 11-14 October 2016), the Committee decided to postpone the discussion of that item of its proposed agenda until the fourteenth session (the thirteenth session being held only seven weeks after the twelfth session) in order to give the Subcommittee an opportunity to meet (see paragraph 9 of note [E/C.18/2016/7](#)).

7. At the fourteenth session of the Committee (New York, in April 2017), which was the last meeting of the previous Committee's membership, the Coordinator of the Subcommittee reported on the outcome of the discussion at the first meeting of the Subcommittee. She indicated that while the Subcommittee had produced new Commentary paragraphs on the meaning of the phrase industrial, commercial and scientific equipment,

...the Subcommittee had been unable to reach a final decision with respect to the characterization of software-related payments. The Subcommittee had, therefore, decided to issue a recommendation for the next membership of the Committee to work on the issue and review the commentary on article 12 in respect of software-related payments.

8. The Committee endorsed that recommendation (paragraphs 2, 26 and 30 of note [E/C.18/2017/3](#)).

9. At the fifteenth session (Geneva, 17-20 October 2017), which was the first meeting of the current membership of the Committee, the Committee decided that, instead of reconstituting the previous Subcommittee on royalties, a Subgroup to examine issues on taxation of software payments as royalties would be formed within the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries.

10. A first paper on the issue (note [E/C.18/2018/CRP.9](#)) was presented by Coordinator of that Subgroup, Mr Rajat Bansal, at the seventeenth session of the Committee. The Paper contained a discussion of the following issues with reference to the OECD Commentary on Article 12 dealing with software payments quoted in the UN Commentary: (a) the classification of software as literary, artistic or scientific work; (b) a distinction between the use of, or the right to use, software and the use of, or the right to use, the copyright underlying software; and (c) arrangements between software copyright holders and distribution intermediaries.

11. The discussion of that note at the seventeenth session is summarized as follows in the report on that meeting (paragraph 99 of note [E/C.18/2019/12](#)):

During the ensuing discussion, several Committee members recognized that those issues were of considerable importance for developing countries, given the rapid development of technology and the extent of its transfer across borders. The need to clarify how the existing definition of royalties should apply to software-related payments was identified as a key issue with respect to the classification of software as literary, artistic or scientific work. Some Committee members also suggested that an alternative approach could be to provide for taxation of those payments in the source State independently from their classification as royalties, given the increasing importance for developing countries of preserving their taxing rights over those payments.

12. While there were no discussions on this topic at the eighteenth and nineteenth sessions, the Coordinator of the Subgroup, at the nineteenth session, invited written comments, by

30 November 2019, on note [E/C.18/2018/CRP.9](#) (Taxation of software payments as royalties), which had been presented at the seventeenth session.

13. Only one country observer sent written comments before the deadline. In light of these comments and the discussion of the note at the seventeenth session, the Coordinator prepared a new note which was distributed to the participants in the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries on 30 March 2020 with a request for written comments by 24 April. That new note by the Coordinator primarily dealt with the following three issues and included an analysis of these issues and specific recommendations:

- (i) Whether there is any difficulty in classifying software as literary, artistic or scientific work for the purposes of the phrase “any copyright of literary, artistic or scientific work” in the definition of royalty in paragraph 3 of Article 12;
- (ii) Whether there should be any elaboration of the view of some former members of the Committee which is expressed in paragraph 12 of the Commentary and which reflects a disagreement with paragraphs 14, 14.1, 14.2, 14.4, 15, 16, 17.2 and 17.3 of the quoted OECD Commentary, indicating that the payments referred to in these paragraphs may constitute royalties;
- (iii) Whether payments for the use of, or the right to use, software itself or a more general concept of “intellectual content” should be treated as “royalties”.

14. A number of Subcommittee participants sent comments in response to that request. The Coordinator responded in writing to some of these comments on 27th April 2020.

Discussion by the Subcommittee

15. The note of 30 March 2020 prepared by the Coordinator of the Subgroup, the written comments received on that note and the Coordinator’s written response to some of these comments were discussed at a short online meeting of the Subcommittee held on 5 May 2020. While the Subcommittee did not have time to discuss comments related to specific paragraphs of the note, it did discuss the general comments received. The majority of these comments suggested that there was a need for more discussion and a more detailed analysis of the issues before recommendations could be formulated.

16. After discussion, the Subcommittee decided that further work was needed before it could present to the Committee a note that would eventually allow decisions to be taken on the issue of the application of Article 12 to software-related payments and some broader policy issues related to the definition of royalties. The discussion also revealed, however, that there was agreement that the following three distinct issues should be examined as part of such further work:

- A. ***Elaboration of the minority view reflected in of paragraph 12 of the Commentary on the UN Model:*** As part of the 2011 update, the following sentence was added immediately after the quoted paragraphs of the OECD Commentary dealing with the application of the definition of royalties to software payments and payments for other digital products: “Some members of the Committee of Experts are of the view that the payments referred to in paragraphs 14, 14.1, 14.2, 14.4, 15, 16, 17.2 and 17.3 of the OECD Commentary extracted above may constitute royalties”. As indicated in paragraph 4 above, it was noted at the eleventh session of the

Committee that this sentence is short on details and does not provide much guidance as to the reasons for that view. The Subcommittee therefore felt that perhaps a better articulation of the minority view reflected in that sentence could be useful.

- B. ***Reconsideration of the part of the Commentary on Article 12 dealing with the application of the definition of royalties to software payments and payments for other digital products:*** In the written comments submitted before the Subcommittee meeting and in some interventions during that meeting, different views were expressed as to whether the guidance on the definition of royalties currently provided in the Commentary on Article 12 of the UN Model was appropriate. It was acknowledged that, beyond clarifying the minority view referred to above, there was a need to further explore whether the current guidance in the Commentary should be improved, modified or replaced. It was agreed, however, that there was no need for additional work on the issue of the classification of software as literary, artistic or scientific work, which was one of the issues previously identified (see paragraph 10 above).
- C. ***Possible modification of the definition of royalties:*** A more fundamental question that was raised during the discussion was whether the definition of royalties currently found in paragraph 3 of Article 12 of the UN Model should be modified in order to refer expressly to payments for the use of, or the right to use, software and, possibly, other digital products or even what was referred to as “any intangible with a substantial intellectual content”. While some participants expressed support for some modification of the definition, others disagreed. It was recognized, however, that any such modification should be carefully considered and would require additional work and consultation.

17. The Subcommittee concluded that given the importance of these issues, work on them should continue at the level of the Subcommittee as a whole without the need for further work by the Subgroup set up during the seventeenth session (see paragraph 9 above) and the Subgroup should be dissolved. Also, some Subcommittee participants stressed the importance of having a live meeting of the Subcommittee in order to further discuss the issues identified above, although it was acknowledged that the holding of such a meeting in the coming months would require a significant easing of the current health-related travel restrictions.

18. Given the practical importance of the work on this topic, the need for extensive consultation, the fact that the current membership of the Committee will be replaced in the middle of 2021 and the fact that live meetings are currently impossible, the Subcommittee recognized that there was a good chance that work on the issues mentioned above would not be completed before the Committee is replaced. It therefore suggests to the Committee to recommend that, if that is the case, the work on these issues be continued by the next membership of the Committee through a Subcommittee specifically set up for that purpose, which would include participants representing various groups of stakeholders.