



15 March 2021

Subcommittee on the United Nations Model Tax Convention
between Developed and Developing Countries
UN Committee of Experts on International Cooperation
in Tax Matters

Dear Members of the Subcommittee:

The International Tax and Investment Center is pleased to respond to your request for comments on the discussion draft of 16 February 2021 concerning proposed changes to the definition of “royalties” under Article 12 of the UN Model Tax Convention.

The International Tax and Investment Center (ITIC) is an independent, non-profit research and education organization founded in 1993 to promote tax reform and public-private initiatives to improve the investment climate in transition and developing economies. ITIC serves as a clearinghouse for information on best practices in taxation and investment policy.

As a general observation, we believe any proposed changes to the UN Model Treaty or Commentary regarding the tax treatment of payments for computer software should seek to clarify and simplify the issues involved in order to enhance compliance and reduce tax disputes. Our reading suggests that the discussion draft does not achieve this objective and may have the opposite effect, when considering the provisions of Article 12, 12A and 12B and potential overlap among them. Because this proposal conflicts with the characterization of payments for computer software adopted in many jurisdictions as the result of decades of analysis and debate, it will likely result in increased disputes, expensive tax controversy and double taxation. These undesirable results will further constrain international trade and foreign investment.

More specifically, we have several concerns about the technical features in the draft, which can be grouped into two main categories below.

Royalty reclassification. In terms of application and definitions, it seems there has been an expansive step taken in classifying the sales of copyrighted software products as royalties. This has typically not been the practice in tax treaty arrangements, and a very recent Supreme Court

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decision in India¹ supports this view. Additionally, the proposal’s distinction between “computer software” and other types of software that may be embedded in devices and products may raise more questions than it answers. As a practical matter, it seems that this is likely to result in additional administrative and compliance burdens, with the risk that the cost of such burdens will ultimately be passed on to the final consumer, often in developing countries.

Gross basis taxation. We urge the Subcommittee to exercise caution when expanding gross basis taxation for certain types of business profits without adequate consideration of associated expenses, in order to avoid the risk of double taxation and misalignment between source country and international markets. Gross basis taxation of business profits is justified only in exceptional cases, and we are concerned that the proposal may not adequately take into account the nature and operation of software businesses – especially the fundamental role and value of research and development in product creation prior to marketing and sales. Further, we note that the proposal moves away from the growing practice in international taxation of reducing withholding tax obligations.

We do note that the Subcommittee is trying to provide solutions to a set of complex and evolving problems in the application of international tax rules. ITIC stands ready to contribute its expertise in helping to address challenges faced by businesses and tax administrations in developing countries. We would welcome an opportunity to participate in the work of the Subcommittee if and when it is open to participation by non-Members of the Committee of Experts.

Thank you for the opportunity to submit these comments, which we are happy to discuss further at your convenience. We look forward to sharing similar commentaries on future workstreams undertaken by the Committee of Experts and its Subcommittees.

Sincerely,



Daniel A. Witt
President

¹ Supreme Court of India, 2 March 2021, decision on group of appeals, with the lead case of Engineering Analysis Centre of Excellence Pvt. Ltd [TS-106-SC-2021].

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