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**Committee of Experts on International
Cooperation in Tax Matters
Twenty-seventh session**

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Item 3(c) of the provisional agenda

**Issues related to the United Nations Model Double Taxation Convention between
Developed and Developing Countries**

Co-Coordinator's Report: The inclusion of software in the definition of royalties

This note is provided to the Committee for *decision* at its Twenty-seventh Session.

At its Twenty-sixth Session, the Committee considered [E/C.18/2023/CRP.13](#), which provided a draft text for paragraph 3 of Article 12 (Royalties) of the UN Model that would include software in the definition of royalties, along with an accompanying Commentary on the draft text. Although the Committee and observers provided comments on the text, the Committee did not consider the question whether the provision should be included in the text of Article 12 of the UN Model itself, or only in its Commentary.

The Article text and accompanying Commentary in this draft are unchanged from [E/C.18/2023/CRP.13](#), except for minor drafting changes in paragraph 13 of the proposed Commentary to clarify the reasoning behind the provision; this clarification responds to a comment from the business community.

Accordingly, the Committee is now asked to:

- a) give *final approval* to replacing current paragraph 3 of Article 12 with the provision in paragraph 4 of this paper, accompanied by the changes to the Commentary on Article 12 set out in paragraph 5;
- b) if not so approved, ask the Subcommittee to redraft the revised Commentary to provide additional guidance for, and to follow, paragraph 16 of the existing Commentary on Article 12.

I. Introduction

1. At its Twenty-fifth Session, the Committee of Experts considered [E/C.18/2022/CRP.24](#), which described the different views within the Subcommittee on how the United Nations Model Double Taxation Convention between Developed and Developing Countries currently applies to payments for the use of computer software and how the work of the Subcommittee on the Update of the UN Model should proceed. The Committee agreed that the Subcommittee should work on developing an expanded definition of royalties that refers to computer software, such as that included in paragraph 16 of the Commentary on Article 12 of the UN Model, including relevant commentary on what would or would not be covered by such an expanded definition (without prejudging whether that expanded definition would be added to the text of Article 12 or be included as a minority position in the Commentary).

2. At its Twenty-sixth Session, the Committee considered [E/C.18/2023/CRP.13](#), which provided a draft text for paragraph 3 of Article 12 that would include software in the definition of royalties, along with an accompanying Commentary on the draft text. Although the Committee and observers provided comments on the text, the Committee did not consider the question of whether the provision should be included in the text of the UN Model.

II. Possible Version of Paragraph 3 of Article 12

3. At the Twenty-sixth session of the Committee, there was support for the Subcommittee's draft text of paragraph 3 of Article 12, which breaks out the separate types of property referred to in the definition of "royalties" and deletes the word "computer" before software. A few observers expressed concern that the new structure would encourage the practice of providing different withholding rates for different categories of royalties, which they believe could lead to arbitrage. As the UN Model does not provide for different withholding rates, the Subcommittee believes that guidance on this point is better addressed in the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries rather than in the Commentary on Article 12.

4. The Subcommittee therefore does not propose any change to the text as discussed at the Twenty-sixth session. Therefore, if approved by the Committee, paragraph 3 of Article 12 would read as follows:

The term "royalties" as used in this Article means payments of any kind:

(a) received as a consideration for the use of, or the right to use:

i) any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting;

ii) any patent, trademark, design or model, plan, or secret formula or process; or

iii) industrial, commercial or scientific equipment; or

(b) received as a consideration for information concerning industrial, commercial or scientific experience; or

(c) received as a consideration for the use of, or the right to use, any software, or paid as a consideration for the acquisition of any copy of software for the purposes of using it.

III. Draft Commentary

5. The following proposed Commentary is provided for the Committee’s consideration. This proposed Commentary would replace paragraphs 12 to 16 of the existing Commentary on Article 12 of the UN Model. Some paragraphs are unchanged but are included to provide context to the Committee. Changes to the existing Commentary are marked with ***bold italics*** and ~~striketrough~~. In paragraph 13 of the Commentary, the changes from the text that had been included in [E/C.18/2023/CRP.13](#) are marked in ***bold italic underline*** and ~~***bold italic striketrough***~~.

12. This paragraph ~~reproduces~~ ***corresponds to*** Article 12, paragraph 2, of the OECD Model Convention, ***but, as explained below, includes specific references to industrial, commercial or scientific equipment and to software,¹ which are not referred to in the OECD definition. It therefore*** does not incorporate the 1992 amendment ***to the OECD definition that*** which eliminates equipment rental from ~~the definition~~ ~~this Article~~. Also, ~~paragraph 3 of Article 12 includes payments for tapes and royalties which are not included in the corresponding provision of the OECD Model Convention. As described below, it expands the coverage of the definition with respect to software beyond payments for the use of, or the right to use, a copyright in software. Paragraph 3 of the UN Model also breaks out separate types of property referred to in the definition of “royalties” for purposes of this Model. This structure was viewed as making the definition easier to read and apply as well as accommodating the common practice of providing different withholding rates for different categories of royalties. The following portions of the OECD Commentary are relevant (the bracketed paragraphs being portions of the Commentary that highlight differences between the United Nations Model Convention and the OECD Model Convention. The Committee considers that the following part of the Commentary on Article 12 of the 2017 OECD Model Convention is applicable to Article 12 of this Model (the modifications that appear in square brackets, which are not part of the Commentary on the OECD Model Convention, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model Convention and those of this Model):~~

13. ~~In 2021, the Committee introduced Article 12B addressing automated digital services. As a result, the downloading of software and some other digital content may be covered by Article 12B and paragraphs 12 to 17.4 of the Commentary on Article 12 of the 2017 OECD Model Tax Convention quoted below should be read accordingly. However, because paragraph 7 of Article 12B provides that “income from automated digital services” does not include payments qualifying as “royalties”, it is still necessary to determine the extent to which the download of software and other digital content constitutes the use of a copyright, in which case a payment for such download would be covered by paragraph 3 of Article 12. In other cases, as explained in the OECD Commentary quoted below, payments in consideration for the download of software and other digital content would not be covered by Article 12 but by Article 7, 12B or 13. Subject to these observations and to the additional comments in paragraphs 14 to 25 below, the Committee considers that the part of the Commentary on Article 12 of the 2017 OECD Model Tax Convention reproduced below, which provides additional explanations on the definition of royalties, is~~

¹ The Committee has not reached an agreement on the proposal to amend the definition of “royalties” in this manner. In order to provide a draft Commentary, however, it is necessary to assume that such a decision has been made, without prejudice to the ultimate Committee disposition of this issue.

~~applicable to paragraph 3 of Article 12 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model Tax Convention, have been inserted in order to provide additional explanations and to reflect the differences between the provisions of the OECD Model Tax Convention and those of this Model):~~

8. Paragraph 2 contains a definition of the term “royalties”. These relate, in general, to rights or property constituting the different forms of literary and artistic property, the elements of intellectual property specified in the text [*industrial, commercial or scientific equipment*] and information concerning industrial, commercial or scientific experience. The definition applies [*for instance*] to payments for the use of, or the entitlement to use, rights [*or property*] of the kind mentioned, whether or not they have been, or are required to be, registered in a public register. The definition covers both payments made under a licence and compensation which a person would be obliged to pay for fraudulently copying or infringing the right.

...

10. Rents in respect of cinematograph films are also treated as royalties, whether such films are exhibited in cinemas or on the television. It may, however, be agreed through bilateral negotiations that rents in respect of cinematograph films shall be treated as business profits and, in consequence, subjected to the provisions of Articles 7 and 9 [*or 12B*].

...

11. In classifying as royalties payments received as consideration for information concerning industrial, commercial or scientific experience, paragraph 2 is referring to the concept of “know-how”. Various specialist bodies and authors have formulated definitions of know-how. The words “payments ... for information concerning industrial, commercial or scientific experience” are used in the context of the transfer of certain information that has not been patented and does not generally fall within other categories of intellectual property rights. It generally corresponds to undivulged information of an industrial, commercial or scientific nature arising from previous experience, which has practical application in the operation of an enterprise and from the disclosure of which an economic benefit can be derived. Since the definition relates to information concerning previous experience, the Article does not apply to payments for new information obtained as a result of performing services at the request of the payer. [*Some members of the Committee, however, are of the view that there is no ground to limit the scope of information of an industrial, commercial or scientific nature to that arising from previous experience*].

11.1 In the know-how contract, one of the parties agrees to impart to the other, so that he can use them for his own account, his special knowledge and experience which remain unrevealed to the public. It is recognised that the grantor is not required to play any part himself in the application of the formulas granted to the licensee and that he does not guarantee the result thereof.

11.2 This type of contract thus differs from contracts for the provision of services, in which one of the parties undertakes to use the customary skills of his calling to execute work himself for the other party. Payments made under the latter contracts generally fall under Article 7 [*12A or Article 14*].

11.3 The need to distinguish these two types of payments, i.e. payments for the supply of know-how and payments for the provision of services, sometimes gives rise to practical difficulties. The following criteria are relevant for the purpose of making that distinction:

— Contracts for the supply of know-how concern information of the kind described in paragraph 11 [of the Commentary on Article 12 of the 2017 OECD Model Tax Convention, as quoted above] that already exists or concern the supply of that type of information after its development or creation and include specific provisions concerning the confidentiality of that information.

— In the case of contracts for the provision of services, the supplier undertakes to perform services which may require the use, by that supplier, of special knowledge, skill and expertise but not the transfer of such special knowledge, skill or expertise to the other party.

— In most cases involving the supply of know-how, there would generally be very little more which needs to be done by the supplier under the contract other than to supply existing information or reproduce existing material. On the other hand, a contract for the performance of services would, in the majority of cases, involve a very much greater level of expenditure by the supplier in order to perform his contractual obligations. For instance, the supplier, depending on the nature of the services to be rendered, may have to incur salaries and wages for employees engaged in researching, designing, testing, drawing and other associated activities or payments to sub-contractors for the performance of similar services.

11.4 Examples of payments which should therefore not be considered to be received as consideration for the provision of know-how but, rather, for the provision of services, include:

- payments obtained as consideration for after-sales service,
- payments for services rendered by a seller to the purchaser under a warranty,
- payments for pure technical assistance,
- payments for a list of potential customers, when such a list is developed specifically for the payer out of generally available information (a payment for the confidential list of customers to which the payee has provided a particular product or service would, however, constitute a payment for know-how as it would relate to the commercial experience of the payee in dealing with these customers),
- payments for an opinion given by an engineer, an advocate or an accountant, and
- payments for advice provided electronically, for electronic communications with technicians or for accessing, through computer networks, a trouble-shooting database such as a database that provides users of software with non-confidential information in response to frequently asked questions or common problems that arise frequently.

11.5 In the particular case of a contract involving the provision, by the supplier, of information concerning computer programming, as a general rule the payment will only be considered to be made in consideration for the provision of such information so as to constitute know-how where it is made to acquire information constituting ideas and principles underlying the program, such as logic, algorithms or programming languages or techniques, where this information is provided under the condition that the customer not disclose it without authorisation and where it is subject to any available trade secret protection.

11.6 In business practice, contracts are encountered which cover both know-how and the provision of technical assistance. One example, amongst others, of contracts of this kind is that of franchising, where the franchisor imparts his knowledge and experience to the franchisee and, in addition, provides him with varied technical assistance, which, in certain

cases, is backed up with financial assistance and the supply of goods. The appropriate course to take with a mixed contract is, in principle, to break down, on the basis of the information contained in the contract or by means of a reasonable apportionment, the whole amount of the stipulated consideration according to the various parts of what is being provided under the contract, and then to apply to each part of it so determined the taxation treatment proper thereto. If, however, one part of what is being provided constitutes by far the principal purpose of the contract and the other parts stipulated therein are only of an ancillary and largely unimportant character, then the treatment applicable to the principal part should generally be applied to the whole amount of the consideration.

[...]

15. Where consideration is paid for the transfer of the full ownership of the rights in the copyright, the payment cannot represent a royalty and the provisions of the Article are not applicable. Difficulties can arise where there is a transfer of rights involving:

- exclusive right of use of the copyright during a specific period or in a limited geographical area;*
- additional consideration related to usage;*
- consideration in the form of a substantial lump sum payment.*

16. Each case will depend on its particular facts but in general if the payment is in consideration for the transfer of rights that constitute a distinct and specific property (which is more likely in the case of geographically-limited than time-limited rights), such payments are likely to be business profits within Article 7 or a capital gain within Article 13 rather than royalties within Article 12. That follows from the fact that where the ownership of rights has been alienated, the consideration cannot be for the use of the rights. The essential character of the transaction as an alienation cannot be altered by the form of the consideration, the payment of the consideration in instalments or, in the view of most countries, by the fact that the payments are related to a contingency.

13. In 202[], the Committee of Experts agreed to amend paragraph 3 to include specific references to software in new subparagraph (c), which does not require the payment to be in consideration for the use of copyright in such software. For example, subparagraph (c) would apply to payments made by a company that is a resident of State S for the use in its business of human resources software that is owned by a company that is a resident of State R. In the view of a [majority] of the Members of the Committee, the addition of subparagraph (c) was necessary because, in their view, Article 12 is intended to cover payments for the letting of property. Accordingly, subparagraph (c) ~~addresses circumstances in which the owner of the~~ allows payments for the use or right to use software earns profits from allowing another person to use that software, without having the owner establish to be taxed by a Contracting State on a gross basis and does not require any presence in the state where it is used, or where the user resides, which would satisfy the requirements of Article 5 for the existence of threshold, such as a permanent establishment or fixed base, as a condition for the taxation of such payments. Subparagraph (c) therefore serves the same function with respect to software as subdivision (a)(iii) serves with respect to industrial, commercial or scientific equipment. In the view of that majority of Members, a person that is making payments for the use of, or the right to use, software described in subparagraph (c) is making a payment in consideration for the letting of that intangible property just as a person that is making payments covered by subdivision (a)(iii) is making a payment in consideration for the letting of tangible property. ~~Whether payments received as consideration for computer software may be classified as royalties poses difficult problems but is a matter of considerable importance in view of the rapid development of computer~~

~~technology in recent years and the extent of transfers of such technology across national borders... In 1992, the Commentary was amended to describe the principles by which such classification should be made. Paragraphs 12 to 17 were further amended in 2000 to refine the analysis by which business profits are distinguished from royalties in computer software transactions. In most cases, the revised analysis will not result in a different outcome.~~

14. A [XX minority] of the Committee opposed including in paragraph 3 an explicit reference to software that was not linked to the use of copyright. In general, they believe that it is appropriate to focus on the business of the person allowing the use of the software or selling a copy of the software, and that person should not be taxable in the source State unless it has a permanent establishment in that State; in that case net taxation would be allowed under Article 7 rather than the gross basis taxation that usually applies under Article 12. Therefore, as a policy matter, they agree with the distinction made by Paragraphs 13.1 and 14 of the Commentary on Article 12 of the OECD Model (quoted in paragraph 24 below) between the use of a copyright right and the use of a copyrighted article, comparing the acquisition of standardized software to the purchase of a product such as a book and arguing that both should give rise to business profits, not royalties and believe that it is appropriate to maintain that distinction. They also do not agree that it is appropriate to compare the use of software with the use of industrial, commercial or scientific equipment. Finally, they point to the arguments against the imposition of a gross basis withholding tax on royalties generally that are described in paragraphs 6 to 9 and 11 of the UN Commentary on Article 12 and conclude that they apply equally with respect to payments for software.

15. The Committee considers that the following part of the Commentary on Article 12 of the 2017 OECD Model Convention is applicable to subparagraph (3)(c) of Article 12 of this Model:

12.1 Software may be described as a program, or series of programs, containing instructions for a computer required either for the operational processes of the computer itself (operational software) or for the accomplishment of other tasks (application software). It can be transferred through a variety of media, for example in writing or electronically, on a magnetic tape or disk, or on a laser disk or CD-ROM. It may be standardised with a wide range of applications or be tailor-made for single users. It can be transferred as an integral part of computer hardware or in an independent form available for use on a variety of hardware.

16. However, the Committee notes that a significant amount of software forms part of embedded systems, consisting of software and hardware designed for a specific function, such as the system that controls a vending machine. Embedded systems may also function as part of a larger system, such as the various embedded systems that control functions in an automobile. The Committee also notes that, since the original adoption of paragraph 12.1 by the OECD, it has become quite common for copies of software to be delivered via digital download or to be accessed remotely.

17. The user may access software through a physical medium or by downloading it through the internet or an intranet. The method by which the software is transferred to the transferee is not relevant to the categorization for purposes of Article 12. Therefore, the definition ensures that Article 12 will apply whether a user downloads software under what is legally a “license” to use that software under domestic law, or “purchases” a copy of software which that user is entitled to use as the legal owner of that copy. In the latter case, any computer file, CD-ROM or other

medium containing the copy of the software that is purchased is the means by which the owner of that copy can access the software, which is the object of the transaction. Because the domestic law can vary in how it treats these economically equivalent transactions, and in some countries it may not be clear whether software is transferred by sale or by license, subparagraph (c) refers not only to the use of software but also to an acquisition of software for the acquiror's own use so as to provide for consistent and reciprocal treatment.

18. Some countries may also be concerned about the effect of the revised definition on individuals. Article 12 has never excluded payments made by individuals from its application. However, the definition of royalties encompassed payments that were, in most cases, paid by businesses so, in practice, individuals seldom made payments that were subject to withholding under Article 12. The addition of subparagraph (c) of paragraph 3, which expands the scope of payments on which source State tax may be imposed, may also require more individuals to withhold tax with respect to such payments (unless the domestic law of the source State exempts those payments). The concern is that individuals are ill-equipped to comply with withholding obligations that may apply with respect to a wide variety of transactions that are generally of low value. Those who share this concern may want to redraft subparagraph (c) to exclude payments for the personal use of software by individuals, as in the following:

(c) received as a consideration for the use of, or the right to use, any software, or paid as a consideration for the acquisition of any copy of software for the purposes of using it, unless the consideration is paid by an individual for the personal use of an individual.

19. The words "for the purposes of using it" at the end of subparagraph (c) are intended to prevent that subparagraph from applying to payments made for the right to distribute software when that right does not include the right to reproduce the software. A [XX minority] of the members of the Committee disagreed with this approach because they believe that it inappropriately narrows the scope of the provision. In their view, payments with respect to such distribution rights should be covered by Article 12 even in the absence of reproduction rights. In some countries, such distribution rights might be covered by subdivision (a)(i) as payment in consideration for the use of copyright in the software. However, countries that want to ensure that result should delete the words "for the purposes of using it" in subparagraph (c).

20. Application of subparagraph (c) will be straightforward in the case of separately-stated payments for software, as in the example provided in paragraph 13. The provision will apply to payments for both standardized software and to payments for software that has been customized to meet the needs of the client. However, it will not apply in cases where the entity using the software has hired another person to develop software that will be owned by the entity using the software, not by the developer; that contract relates to the provision of services by the developer and any payments made to the developer will be either fees for technical services, if the relevant treaty includes Article 12A, or business profits under Article 7. [Some] Members feel that Article 12 should not apply to payments for the use of standardized software. Those who share this view may want to redraft subparagraph (c) to apply only to software that has been modified for the user thereof, as in the following:

(c) received as a consideration for the use of, or the right to use, any software that is not standardized but that has been adapted in some way for the benefit of the user thereof, or

paid as a consideration for the acquisition of any copy of such software, for the purposes of using it.

21. *On the other hand, if software is embedded in physical goods or is bundled with the acquisition of other goods and services, the application of subparagraph (c) becomes more difficult. The guidance regarding mixed contracts in paragraph 12 (quoting paragraph 11.6 of the Commentary on Article 12 of the OECD Model) would apply. The Committee also considers that the following part of the Commentary on Article 12 of the 2017 OECD Model Convention is applicable to Article 12 of this Model:*

17. Software payments may be made under mixed contracts. Examples of such contracts include sales of computer hardware with built-in software and concessions of the right to use software combined with the provision of services. The methods set out in paragraph 11.6 above for dealing with similar problems in relation to patent royalties and know-how are equally applicable to ~~...computer~~ software. Where necessary the total amount of the consideration payable under a contract should be broken down on the basis of the information contained in the contract or by means of a reasonable apportionment with the appropriate tax treatment being applied to each apportioned part.

22. *In general, therefore, the appropriate course is to break down the whole amount of the consideration among the various parts of what is being provided under the contract on the basis of information in the contract or a reasonable apportionment of that consideration. However, paragraph 11.6 of the Commentary on Article 12 of the OECD Model, quoted in paragraph 12 above, also notes that, "if...one part of what is being provided constitutes by far the principal purpose of the contract and the other parts... are only of ancillary and largely unimportant character" then the treatment applicable to the principal part should apply to the entire consideration under the contract. Accordingly, in most cases, the sale of a physical good that incorporates various intangibles need not be disaggregated into its component parts and the entire purchase price should be treated as giving rise to business profits, not royalties.*

23. *In light of these interpretative issues, some countries may want to exclude from the definition in paragraph 3 payments for software that is embedded in a physical product or part of a contract for services. A revised subparagraph to implement such an exclusion might read:*

(c) received as a separately-stated consideration for the use of, or the right to use, any software, or paid as a separately-stated consideration for the acquisition of any copy of software for the purposes of using it.

Even if countries do not agree to include this provision, they may want to discuss the issues of interpretation described above during the negotiations to ensure that both parties have reached a common understanding regarding the manner in which the provision will be applied.

24. *Payments in consideration for the use of, or the right to use, a copyright in software may also be covered by subdivision (a)(i). This subdivision will be particularly important with respect to payments for the right to distribute software. Accordingly, the Committee considers that the following part of the Commentary on Article 12 of the 2017 OECD Model is applicable for purposes of interpreting subdivision (a)(i) of paragraph 3 of Article 12 of this Model with respect to software (the modifications that appear in square brackets, which are not part of the Commentary on the OECD Model Convention, have been inserted in order to provide additional*

explanations or to reflect the differences between the provisions of the OECD Model Convention and those of this Model):

12.2 The character of payments received in transactions involving the transfer of computer software ***[under subdivision (a)(i) of paragraph 3]*** depends on the nature of the rights that the transferee acquires under the particular arrangement regarding the use and exploitation of the program. The rights in computer programs are a form of intellectual property. Research into the practices of OECD member countries has established that all but one protects rights in computer programs either explicitly or implicitly under copyright law. Although the term “computer software” is commonly used to describe both the program—in which the intellectual property rights (copyright) subsist—and the medium on which it is embodied, the copyright law of most OECD member countries recognises a distinction between the copyright in the program and software which incorporates a copy of the copyrighted program. Transfers of rights in relation to software occur in many different ways ranging from the alienation of the entire rights in the copyright in a program to the sale of a product which is subject to restrictions on the use to which it is put. The consideration paid can also take numerous forms. These factors may make it difficult to determine where the boundary lies between software payments that are properly to be regarded as royalties and other types of payment. The difficulty of determination is compounded by the ease of reproduction of computer software, and by the fact that acquisition of software frequently entails the making of a copy by the acquirer in order to make possible the operation of the software.

13. The transferee’s rights will in most cases consist of partial rights or complete rights in the underlying copyright (see paragraphs 13.1 and 15 ~~below~~ ***[of the Commentary on Article 12 of the OECD Model]***), or they may be (or be equivalent to) partial or complete rights in a copy of the program (the “program copy”), whether or not such copy is embodied in a material medium or provided electronically (see paragraphs 14 to 14.2 below). In unusual cases, the transaction may represent a transfer of “know-how” or secret formula (paragraph 14.3).

13.1 Payments made for the acquisition of partial rights in the copyright (without the transferor fully alienating the copyright rights) will represent a royalty ***[in accordance with subdivision (a)(i) of paragraph 3 of Article 12 of this Model]*** where the consideration is for granting of rights to use the program in a manner that would, without such license, constitute an infringement of copyright. Examples of such arrangements include licenses to reproduce and distribute to the public software incorporating the copyrighted program, or to modify and publicly display the program. In these circumstances, the payments are for the right to use the copyright in the program (i.e. to exploit the rights that would otherwise be the sole prerogative of the copyright holder). It should be noted that where a software payment is properly to be regarded as a royalty there may be difficulties in applying the copyright provisions of the Article to software payments since paragraph 2 requires that software be classified as a literary, artistic or scientific work. None of these categories seems entirely apt. The copyright laws of many countries deal with this problem by specifically classifying software as a literary or scientific work. For other countries treatment as a scientific work might be the most realistic approach. Countries for which it is not possible to attach software to any of those categories might be justified in adopting in their bilateral treaties an amended version of paragraph 2 which either omits all references to the nature of the copyrights or refers specifically to software.

14. In other types of transactions, the rights acquired in relation to the copyright are limited to those necessary to enable the user to operate the program, for example, where the transferee is granted limited rights to reproduce the program. This would be the common situation in transactions for the acquisition of a program copy. The rights transferred in these cases are specific to the nature of computer programs. They allow the user to copy the program, for example onto the user's computer hard drive or for archival purposes. In this context, it is important to note that the protection afforded in relation to computer programs under copyright law may differ from country to country. In some countries the act of copying the program onto the hard drive or random access memory of a computer would, without a license, constitute a breach of copyright. However, the copyright laws of many countries automatically grant this right to the owner of software which incorporates a computer program. Regardless of whether this right is granted under law or under a license agreement with the copyright holder, copying the program onto the computer's hard drive or random access memory or making an archival copy is an essential step in utilising the program. Therefore, rights in relation to these acts of copying, where they do no more than enable the effective operation of the program by the user, should be disregarded in analysing the character of the transaction for the purposes *[of subdivision (a)(i) of paragraph 3 of Article 12 of this Model]*. ~~Payments in these types of transactions would be dealt with as commercial income in accordance with Article 7.~~

14.1 The method of transferring the computer program to the transferee is not relevant. For example, it does not matter whether the transferee acquires a computer disk containing a copy of the program or directly receives a copy on the hard disk of her computer via a modem connection. It is also of no relevance that there may be restrictions on the use to which the transferee can put the software.

14.2 The ease of reproducing computer programs has resulted in distribution arrangements in which the transferee obtains rights to make multiple copies of the program for operation only within its own business. Such arrangements are commonly referred to as "site licences", "enterprise licenses", or "network licences". Although these arrangements permit the making of multiple copies of the program, such rights are generally limited to those necessary for the purpose of enabling the operation of the program on the licensee's computers or network, and reproduction for any other purpose is not permitted under the license. Payments under such arrangements will in most cases be *[outside the scope of subdivision (a)(i) but could be covered by subparagraph (c) of the definition of royalties]* ~~dealt with as business profits in accordance with Article 7.~~

25. A [XX minority] of the Committee did not oppose the amendment of paragraph 3 but did not agree with this interpretation of subdivision (a)(i). They are of the view that the definition in paragraph 3 of Article 12 of the UN Model before the change made in [202] already allowed a source country to tax payments for the use of software. This position is based on the copyright laws of their countries which either explicitly or implicitly classify software as a literary, artistic or scientific work. Therefore, in their view a payment for software will represent a royalty payment where the consideration is for granting of rights to use the program in a manner that would, without such a license, constitute an infringement of copyright, as in the situations described in paragraphs 14, 14.1 and 14.2 of the quoted OECD Commentary. For these purposes, they view the reliance placed in paragraphs 14 and 14.2 of the quoted OECD Commentary on the purpose for which the software is copied to be incorrect; they do not believe that commercial

*exploitation of a copyright by the user is necessary in order to characterize the payment as a royalty.*²

26. The Committee considers that the following part of the Commentary on Article 12 of the 2017 OECD Model is applicable for purposes of interpreting subdivision (a)(i) of paragraph 3 of Article 12 of this Model as it applies to computer software (the modifications that appear in square brackets, which are not part of the Commentary on the OECD Model Convention, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model Convention and those of this Model):

14.3 Another type of transaction involving the transfer of computer software is the more unusual case where a software house or computer programmer agrees to supply information about the ideas and principles underlying the program, such as logic, algorithms or programming languages or techniques. In these cases, the payments may be characterised as royalties to the extent that they represent consideration for the use of, or the right to use, secret formulas or for information concerning industrial, commercial or scientific experience which cannot be separately copyrighted. This contrasts with the ordinary case in which a program copy is acquired for operation by the end user.

14.4 Arrangements between a software copyright holder and a distribution intermediary frequently will grant to the distribution intermediary the right to distribute copies of the program without the right to reproduce that program. In these transactions, the rights acquired in relation to the copyright are limited to those necessary for the commercial intermediary to distribute copies of the software program. In such transactions, distributors are paying only for the acquisition of the software copies and not to exploit any right in the software copyrights. Thus, in a transaction where a distributor makes payments to acquire and distribute software copies (without the right to reproduce the software), the rights in relation to these acts of distribution should be disregarded in analysing the character of the transaction for tax purposes. Payments in these types of transactions would be dealt with as business profits in accordance with Article 7. This would be the case regardless of whether the copies being distributed are delivered on tangible media or are distributed electronically (without the distributor having the right to reproduce the software), or whether the software is subject to minor customisation for the purposes of its installation.

27. A [XX minority] of the Committee did not agree with this interpretation of subdivision (a)(i). They view the payments described in paragraph 14.4 of the quoted OECD Commentary as in the nature of royalties because the right to distribute is a use of a copyright, which is a valuable economic right of the copyright owner which exists independently of other rights in the copyright, including the copying right and the exhibition right. They also view it as impracticable to disaggregate the payment towards consideration for various uses.

~~15. Where consideration is paid for the transfer of the full ownership of the rights in the copyright, the payment cannot represent a royalty and the provisions of the Article are not applicable. Difficulties can arise where there is a transfer of rights involving:~~

²² This view, initially recorded at the seventh session (October 2011) of the Committee, was elaborated upon by Members of the Committee in conjunction with the 2021 and [] updates of the United Nations Model Tax Convention.

- ~~_____ exclusive right of use of the copyright during a specific period or in a limited~~
- ~~_____ geographical area;~~
- ~~_____ additional consideration related to usage;~~
- ~~_____ consideration in the form of a substantial lump sum payment.~~

~~16. Each case will depend on its particular facts but in general if the payment is in consideration for the transfer of rights that constitute a distinct and specific property (which is more likely in the case of geographically limited than time limited rights), such payments are likely to be business profits within Article 7 (or 14 in the case of the United Nations Model Convention) or a capital gain within Article 13 rather than royalties within Article 12. That follows from the fact that where the ownership of rights has been alienated, the consideration cannot be for the use of the rights. The essential character of the transaction as an alienation cannot be altered by the form of the consideration, the payment of the consideration in instalments or, in the view of most countries, by the fact that the payments are related to a contingency.~~

28. There are possible overlaps between the provisions of Articles 12, 12A and 12B. For example, the downloading of software and some other digital content may be covered by the definition of “automated digital services” in paragraph 5 of Article 12B and the definition of “royalties” in paragraph 3 of Article 12. However, paragraph 7 of Article 12B provides that “income from automated digital services” does not include payments defined as “royalties”. A payment in consideration for the online acquisition of a copy of standardized accounting software for use in a business would be within the scope of Article 12 because the purpose of the transaction was the acquisition of a copy of the software for the use of the payor. Such payment therefore would not be subject to Article 12B. However, Article 12 does not apply to the free downloading of software to facilitate what is fundamentally a different type of transaction, such as the acquisition of goods or the receipt of services. Thus, if a merchant provides free application software to facilitate the on-line purchase of goods, sales of such goods will give rise to business profits which are subject to Article 7 (see paragraph 60(iv) of the Commentary on Article 12B). Similarly, free downloads of application software to access online intermediation platform services or online gaming, which are intended to facilitate automated digital services, would not implicate Article 12, so that the entire profit would fall within the scope of Article 12B. However, if the user makes a separate payment in order to download the application software, that payment would be subject to Article 12.

29. In the case of digital content (other than software described in subparagraph (c) of paragraph 3 of Article 12), it is necessary to determine the extent to which the download of such digital content constitutes the use of a copyright, in which case a payment for such download would be covered by paragraph 3(a)(i) of Article 12. In other cases, as explained in the OECD Commentary quoted below, payments in consideration for the download of digital content (other than software) would not be covered by Article 12 but by Article 7, 12B or 13. The Committee considers that the part of the Commentary on Article 12 of the 2017 OECD Model Tax Convention reproduced below, which provides additional explanations on the definition of royalties in the case of payments for digital content, is applicable to subdivision (a)(i) of paragraph 3 of Article 12 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model Tax Convention, have been

inserted in order to provide additional explanations and to reflect the differences between the provisions of the OECD Model Tax Convention and those of this Model):

17.1 The principles expressed above as regards software payments are also applicable as regards transactions concerning other types of digital products such as images, sounds or text. The development of electronic commerce has multiplied the number of such transactions. In deciding whether or not payments arising in these transactions constitute royalties, the main question to be addressed is the identification of that for which the payment is essentially made.

17.2 Under the relevant legislation of some countries, transactions which permit the customer to electronically download digital products may give rise to use of copyright by the customer, e.g. because a right to make one or more copies of the digital content is granted under the contract. Where the consideration is essentially for something other than for the use of, or right to use, rights in the copyright (such as to acquire other types of contractual rights, data or services), and the use of copyright is limited to such rights as are required to enable downloading, storage and operation on the customer's computer, network or other storage, performance or display device, such use of copyright should not affect the analysis of the character of the payment for purposes of applying *[subdivision (a)(i) of]* the definition of "royalties".

17.3 This is the case for transactions that permit the customer (which may be an enterprise) to electronically download digital products (such as software, images, sounds or text) for that customer's own use or enjoyment. In these transactions, the payment is essentially for the acquisition of data transmitted in the form of a digital signal and therefore does not constitute royalties *[under subdivision (a)(i) of paragraph 3 of Article 12 of this Model]* but falls within *[subparagraph (c) of that paragraph or]* Article 7*], 12B]* or Article 13, as the case may be. To the extent that the act of copying the digital signal onto the customer's hard disk or other non-temporary media involves the use of a copyright by the customer under the relevant law and contractual arrangements, such copying is merely the means by which the digital signal is captured and stored. This use of copyright is not important for classification purposes because it does not correspond to what the payment is essentially in consideration for (i.e. to acquire data transmitted in the form of a digital signal), which is the determining factor for the purposes of the definition of royalties. There also would be no basis to classify such transactions as "royalties" *[under subdivision (a)(i)]* if, under the relevant law and contractual arrangements, the creation of a copy is regarded as a use of copyright by the provider rather than by the customer.

17.4 By contrast, transactions where the essential consideration for the payment is the granting of the right to use a copyright in a digital product that is electronically downloaded for that purpose will give rise to royalties. This would be the case, for example, of a book publisher who would pay to acquire the right to reproduce a copyrighted picture that it would electronically download for the purposes of including it on the cover of a book that it is producing. In this transaction, the essential consideration for the payment is the acquisition of rights to use the copyright in the digital product, i.e. the right to reproduce and distribute the picture, and not merely for the acquisition of the digital content.

30. A [XX minority] of the Committee is of the view that the payments referred to in paragraphs 17.2 and 17.3 of the OECD Commentary extracted above may constitute royalties, without regard to subparagraph (c).

31. There is less risk of overlap between Article 12 and Article 12A or Article 14 as regards payments for software, because Articles 12A and 14 apply to the provision of services, such as software consulting, that involve human input, while Article 12 relates to the use of property.

14. As explained at the beginning of paragraph 13 above, it is necessary to take account of the addition of Article 12B to the United Nations Model Tax Convention when reading paragraphs 12 to 17.4 of the Commentary on Article 12 of the 2017 OECD Model Tax Convention quoted above.

15. Also, some members of the Committee 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 Commentary on Article 12 of the OECD Model Tax Convention quoted in paragraph 13 above may constitute royalties. This view, initially recorded at the seventh session (October 2011) of the Committee, was elaborated upon by members of the Committee in conjunction with the 2021 update of the United Nations Model Tax Convention. The view of these members⁵² is that the situations described in paragraphs 14 and 14.2 of the quoted OECD Commentary should give rise to royalties because, contrary to the conclusions in those paragraphs, the fact that the copying of computer software or other digital product would constitute a violation of copyright if done without a license means that the user is using copyright when that user operates the program or downloads the digital product. For these purposes, they view the reliance placed in paragraphs 14 and 14.2 of the quoted OECD Commentary on the purpose for which the software is copied to be incorrect; they do not believe that commercial exploitation of a copyright by the user is necessary in order to characterize the payment as a royalty. As a result, they believe that whenever the use of a copy of a copyright work entails use of the copyright in the work, even if it is a permitted use under the law of the country concerned, a payment for that use should be considered a royalty. With respect to paragraph 14.4 of the quoted OECD Commentary, the payments in question are viewed by them to be in the nature of royalties as the right to distribute is a use of a copyright, which is a valuable economic right of the copyright owner which exists independently of other rights in the copyright, including the copying right and the exhibition right. In all of these cases, they view it as impracticable to disaggregate the payment towards consideration for various uses.

16. In the view of a large minority of the members of the Committee,⁵³ Article 12 should allow for source State taxing rights even in cases where the user of computer software is not exploiting the copyright in the software. In their view, Article 12 is intended to cover payments for the letting of property, which is broader than use of the copyright. For example, if a company that is a resident of State S uses in its business human resources software that is owned by a company that is a resident of State R, payments made for that use would not be covered by the current definition of royalties in paragraph 3 of Article 12. In their view, Article 12 should address circumstances in which the owner of the computer software earns profits from letting another person use that computer software, without having the owner establish any presence in the State where it is used, or where the user resides, which would satisfy the requirements of Article 5 for the existence of a permanent establishment. In the view of those Members, a person that is making payments for the use of, or the right to use, computer software is making a payment in consideration for the letting of that intangible property just as a person that is making payments for the use of industrial, commercial or scientific equipment (already included in paragraph 3) is making a payment in consideration for the letting of tangible property. States sharing this view may want to include at the end of paragraph 3 the following sentence:

~~The term also includes payments of any kind received as consideration for the use of, or the right to use, any computer software, or the acquisition of any copy of computer software for the purposes of using it.~~

Issues for the Committee

6. The Committee is now asked to:

a) give *final approval* to replacing current paragraph 3 of Article 12 with the provision in paragraph 4 of this paper, accompanied by the changes to the Commentary on Article 12 set out in paragraph 5;

b) if not so approved, ask the subcommittee to redraft the revised Commentary to provide additional guidance for, and to follow, paragraph 16 of the existing Commentary on Article 12.