



November 25, 2019

VIA EMAIL

Carmel Peters, Coordinator

UN Tax Committee Sub-Committee on UN Model Tax Convention between Developed and Developing Countries

Re: Consideration of Issues Relating to the Taxation of Software

Background

The UN Committee of Tax Experts that concluded its work in 2017 updated the UN Model Convention but did not include changes relating to the taxation of software payments. This was despite having a subcommittee tasked with reviewing the taxation of software. The mandate of that subcommittee was:

"The Subcommittee is to consider and report on possible improvements to the commentary on Article 12 (Royalties) of the Model, and if required, the text of that Article. It is mandated to initially report to the Committee at the October session of the Committee in 2016, addressing as its initial priority such improvements to the commentary discussion on industrial, commercial and scientific equipment **and software related payments** as are most likely to be accepted by the Committee for its inclusion in the next version of the UN model."

That subcommittee was unable to reach agreement and, therefore, the Model (and the commentary) were not updated with respect to this issue.

The reconstituted committee again took up the issue,¹ although in a somewhat different manner. Instead of having a subcommittee with its own mandate, the subcommittee on the UN Model has a subgroup tasked with examining issues "on taxation of software payments as royalties". Unlike the prior subcommittee, business has not been permitted to engage with this subgroup, so we are not informed on the details of the discussion on this topic.

At the most recent meeting of the committee, the subgroup asked the subcommittee on the UN Model to take over this work.

¹¹ See the [Report on the Sixteenth Session of the Committee](#), paragraph 64.

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Comments

First, USCIB strongly supports an open, consultative process. Therefore, if the full subcommittee on the UN Model is going to take on this work, USCIB believes it is important to include business representatives in the discussion in order to ensure that any decisions the subcommittee (and the full committee) may make are based on a genuine understanding of the business models (and licensing practices) of companies operating in this industry. USCIB would be pleased to participate in such a process.

Second, USCIB believes that the current guidance provided by the Article 12 and the Commentary to Article 12 of the UN Model² is generally correct and does not need to be updated. Article 12 of the current Model includes within its scope royalties as defined under Article 12(3) which provides:

The term “royalties” as used in this Article means payments of any kind received as a **consideration for the use of, or the right to use, any copy-right of literary, artistic or scientific work** including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience. (Emphasis added.)

Copyright rights exist to protect the copyright owner and they prohibit others from exercising copyright rights with respect to the copyrighted work (the computer program). Copyright protection applies to the software source code. Copyright rights are protected by the national copyright laws of the country in which the author seeks protection, regardless of where the author lives or where a work was first published.

There are four copyright rights relevant to the analysis under Article 12(3):

- i. The right to reproduce the copyrighted work
- ii. The right to distribute copies of the work to others
- iii. The right to make derivative works based on the copyrighted work
- iv. The right to perform or display the work publicly

If the software copyright owner permits the payor to exercise one or more of the owner’s copyright rights with respect to the work in exchange for a payment, the payment for the use of the copyright right would be a royalty under Article 12(3). This is the conclusion reached under the Commentary to Article 12(3). Whether such a right has been granted would be determined under the contract between the copyright owner and the payor.

² UN Model Commentary on Article 12, paragraphs 12 through 17.4.

A copyright owner may, by contract, transfer or assign all or a portion of its exclusive copyright rights to another party. In which case, the income from the transaction would be treated either as the sale of a copyright or as a royalty.

A copyright owner may also give another party permission to use (or “license”) a copyrighted work without transferring its copyright rights. When a copyrighted work is used under this type of license, the payor is not obtaining a copyright right, but a contractual right to use a copyrighted article. In which case the income from the transaction would be treated as business profits.

Software is generally provided under a license agreement that provides additional, contractually-based, protections for the copyright owner not available in copyright law. Nevertheless, the use of the word “license” and not “sale” does not convert a permission to use the copyrighted work into a transfer of copyright rights.

Third, USCIB believes that consideration of this issue should be deferred. The current work by the Inclusive Framework (IF) on the tax challenges of the digitalizing economy may result in substantial changes to the international tax framework. If changes are to be made to the taxation of software royalties (which USCIB does not recommend), such changes should only be made after the Inclusive Framework finishes its work, so that the IF’s changes to framework can be considered in determining the proper answers.

The current Committee must complete its work by the spring of 2021, as the Committee will be reconstituted following its spring 2021 meeting. The Committee has also adopted a “two readings” requirement. That is (as USCIB understands it), the Committee cannot approve a proposal unless the full Committee has had two opportunities to review the proposal. Since there has not been a proposal on this issue yet, the Committee would have to review the proposal for the first time no later than the fall of 2020. Given that no progress has been made over several years on this issue, it seems unlikely that the subcommittee and full Committee would be able to achieve consensus in that timeframe.

USCIB, therefore, recommends that this issue not be taken up, but instead be deferred until after action by the Inclusive Framework, which would likely mean that it should be taken up, if at all, by the Committee as reconstituted in 2021.

Sincerely,

A handwritten signature in black ink, appearing to read 'W. Sample', written in a cursive style.

William J. Sample
Chair, Taxation Committee
United States Council for International Business (USCIB)

cc: Michael Lennard, Chief of Unit, International Tax and Development Cooperation Branch