The **BEPS** Monitoring Group

INCLUSION OF SOFTWARE PAYMENTS IN THE DEFINITION OF ROYALTIES IN ARTICLE 12 OF THE UN MODEL TAX CONVENTION

This submission to the UN Committee of Experts on International Cooperation in Tax Matters has been prepared by the BEPS Monitoring Group (BMG). The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. This report has not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives. It is based on our previous reports, and has been drafted by Sol Picciotto and Abdul Muheet Chowdhary, with comments from Attiya Waris.

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SUMMARY

We welcome the opportunity to comment on this draft. Unfortunately, in our view it is seriously defective, since it is based on and would perpetuate a confused and misleading understanding of copyright introduced in 1992 in the OECD Commentary. This interpretation was rejected by many states, many of which have chosen to clarify their actual treaties by including a specific mention of computer programs as examples of copyright work. This draft proposes a different approach which could have retroactive effects on these treaties and deprive many states of taxing rights. We urge the Committee to adopt instead a simple clarification of the model based on these existing treaties. To contribute to a rapid conclusion of this work we provide a draft for five paragraphs of Commentary to accomplish this task.

With regard to the specific questions raised, the following are our responses:

1. No definition of 'software' is needed in article 3.
2. The question is not the nature of the device on which the program or software is installed, but whether the payments are made for the use of or the right to use the program or software.
3. Sub-para (c) of the proposal is contradictory and confusing and should be removed.

1. GENERAL COMMENTS

We welcome this opportunity to comment on the proposal to amend Article 12 of the UN Model Tax Convention between Developed and Developing countries and its Commentary, to clarify its application to payments for the use of computer programs or software.

Payments for the use of copyright in computer programs or software are made mainly by business users. When such payments are made to a non-resident they cause direct tax losses in source countries, since they are deductible as costs and hence reduce the payor's taxable business profits. Furthermore, multinational enterprises (MNEs) particularly in the business software sector, can route these revenues through conduits in countries where they are subject to low or no tax, so generating untaxed income. Hence, depriving countries of the right to tax royalty payments to non-residents causes both direct losses of tax revenues for these source countries, and enables significant overall global tax losses from avoidance (base erosion and profit shifting).

Computer programs are now almost universally protected as copyright works.[1] Hence, there should be no doubt that payments for the rights in the copyright of a computer program can be treated as royalties under article 12. Confusion on this point has arisen due to changes that were made to the OECD Commentary on article 12 in 1992, further revised in 2000, introducing a restrictive interpretation of the article. This interpretation was rejected by some OECD members, as well as some members of the UN Committee.

In fact, states which hold this alternative view have followed a different approach, by simply mentioning computer programs or software among the examples in the definition of royalties in their treaties, for the avoidance of doubt. There seem to be some 600 bilateral agreements in force which include such a reference.[2] In our view, this simple inclusion is the best way to confirm that article 12 applies to the use of rights in copyright in computer programs or software. In this way, the UN model would be brought into line with the existing practice of states that did not accept the OECD interpretation. There are some differences in the way computer programs or software have been included in these treaties, so it would be helpful to standardise the provision in the UN model. Some suitable commentary can be added to explain this, which would also be applicable to these existing treaties. Many treaties have also remained unchanged, so the Commentary should also make it clear that non-OECD members and other states which did not accept the interpretation introduced by the OECD in 1992 are not obliged to do so.

This approach would be far easier and simpler than the changes proposed in the discussion draft. This draft is highly complex and difficult to understand, largely because it attempts to combine conflicting interpretations. It also perpetuates confusions about the nature of copyright which originated with the revised OECD commentary. Copyright is not an easy concept to understand or explain, and this is particularly difficult for computer programs, which are distinctive in that they are functional rather than creative works. They have

[1] In the early 1990s some argued that computer programs should not be treated as creative literary works and protected by copyright, but as functional technical innovations and hence industrial property. The powerful business software lobbies secured both types of protection: many computer programs can now obtain patents, and copyright protection was obtained in almost all countries through the obligation in s.10 of the Agreement on Trade Related Property Rights (TRIPs) of 1995, which is binding on all members of the World Trade Organisation.

[2] A search conducted in Tax Analysts' database of Worldwide Tax Treaties in March 2021 identified 29 in-force treaties that mention the term 'computer program', and 653 that include the term 'software'. Checks on a selection of these confirmed that the reference is in a provision on royalties, but this may not be so for all cases, and there may be some double counting due to the inclusion of treaties in two language versions. Some treaties provide for different tax rates for various categories of royalty.

nevertheless been given copyright protection, which enables rights in them to generate income which clearly constitutes royalties. This should be explained in the Commentary as clearly and simply as possible.

In this way, the UN model would provide a distinct alternative to the OECD model for negotiators.[3] This alternative would clearly protect source taxation, which is important especially for developing countries. Attempting to combine the OECD approach with the inclusion of separate provisions for computer software results in an unsatisfactory compromise, creating complexity and confusion. Furthermore, it would have retroactive effect on the interpretation of existing treaties, depriving non-OECD members and other states which did not accept the interpretation of article 12 introduced by the OECD in 1992 of taxing rights. Finally, it is unnecessary, as a simple revision, if properly interpreted in the Commentary, would produce outcomes that can be widely accepted as fair.

We will respond first to the specific questions posed in the discussion draft, and then outline our alternative proposal. Finally, we provide draft Commentary for the simple revision to the article that we propose.

2. Responses to Specific Questions

2.1 Software

The term software simply refers to the entire set of computer programs and instructions that enable a computer or other device to run, as opposed to its hardware.[4] The description in the OECD Commentary paragraph 12.2 mistakenly suggests that the term 'software' can be used to describe 'the medium on which [a program] is embodied', whereas the term software was devised to distinguish between a computer program and the 'hardware' medium on which it is embodied. It then makes a distinction between copyright in a program and 'software which incorporates a copy of the copyrighted program', which is confused and misleading. A program or software is incorporated (more accurately, embodied) in hardware. The most important distinction that needs to be made is between payment for rights in a copyright work, such as a computer program, and acquisition of a physical product in which a copy of a computer program or software is embedded. The OECD Commentary is often confusing on this distinction. The draft proposal would perpetuate this confusion, and build on it an undesirable and unnecessary distinction between computer software and other types of copyright work. New commentary is needed to clarify the scope of the article when applied to rights in the copyright of a work such as a computer program.

Hence, no definition of 'software' is needed in article 3. Technology changes rapidly, and the relationship between computer programs or software and physical products will continue to evolve. Tax treaties are infrequently renegotiated, and attempting to fix a definition would result in complex and unnecessary disputes. The key question for article 12 is not the definition of software, but whether payments are made for the use of or the right to use a work protected as copyright.

2.2 Computers

The scope of application of the article should not depend on defining the term 'computer'. This is already difficult, and will become more so as physical products and devices dependent on computer programs and software become ever more ubiquitous. The question is not the

[3] For an argument that this is needed see Gattaz MW (2019) Taxation of Royalties (Article 12). In: Binder A and Wöhrer V (eds) *Special Features of the UN Model Convention*. Linde Verlag pp.261-279.
[4] See www.britannica.com.

nature of the device on which the program or software is installed, but whether the payments are made for the use of or the right to use the program or software.

2.3 Distribution Rights

All rights governed by copyright should be within the scope of the article, including distribution rights. As correctly explained in the Annex, the resale of a physical product which embodies a copyright work may not entail infringement of copyright, under the doctrine of exhaustion. In that case, payment for the acquisition of the product is not consideration for a right protected by copyright. Thus, sub-paragraph (c) of the proposal is contradictory and confusing. It should be removed, and computer software should not be treated as a separate type of property in sub-paragraph (a) but as a work protected by copyright.

3. OUR PROPOSAL

Article 12.3 of the Model should be revised as follows (change marked in bold):

> 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 copyright of literary, artistic or scientific work including **any computer program or software,** 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.

The term software simply refers to the entire set of computer programs and instructions that enable a computer or other device to run, as opposed to its hardware.[5] Both terms should be included, for the avoidance of doubt.

The Commentary should explain that the article applies to **payments** for 'the **use of or the right to use**' **the copyright** in a program or software.

This does not include:

> (i) payments for the outright acquisition of the copyright in a program;
>
> (ii) payments to purchase hardware which includes embedded programs or software;
>
> (iii) payments for services delivered through a computer program or software application.

None of these constitute payments for rights to use the copyright in the program or software.

It does include:

> (i) payments for the right to run or operate a computer program or software by making a copy;
>
> (ii) payments for the right to distribute to the public a computer program or software.

To clarify this, the Commentary should include a clear explanation of the nature of rights in copyright. The most important distinction that needs to be made is between payment for rights in a copyright work, such as a computer program, and acquisition of a copy of a computer program or software, particularly when embedded in a physical product or medium.

[5] See www.britannica.com. The OECD Commentary (para. 12.2) makes the misleading assertion that there is 'a distinction between the copyright in the program and software which incorporates a copy of the copyrighted program'. The program or software is incorporated (more accurately, embodied) in hardware.

The scope of application of the article then depends on whether (i) the acquisition entails a right in copyright, and (ii) the payment is consideration for such a right in copyright.

A computer program consists of instructions transmitted electronically, but it is also necessarily embodied in physical form: on paper (rarely), on a microprocessor chip (e.g. in a computer, or a car) or on an optical disc (CD/DVD) or readable hard drive. Programs embodied on a chip are rapidly becoming ubiquitous with the emergence of the 'internet of things'. Importantly, however, a purchaser rarely acquires any rights in the copyright to such embedded programs. The situation is different for computer programs intended to be operated by the purchaser as a user. These may be supplied embedded physically on a readable disc or drive, or electronically for download. In both cases the supply entails the grant of a right to use the copyright work by making a copy on the user's computer or device. Frequently, however, software is provided for no payment (gratis), e.g. to facilitate the provision of other services, or to enable the functioning of the physical device or hardware that is the main object of the transaction. In these cases, the payment may be regarded as being either for the supply of the services, or for the hardware, and not for rights in the copyright of the software.

The purchaser of a physical item which embodies a copyright work acquires ownership of that physical item, like any other, including the embodied copy of the work. However, the *uses* which can be made of that copy are limited by copyright. For example, the purchaser of a book owns the physical copy, but not the rights in the copyright work embodied in it. Copyright controls the uses that can be made of the copyright in the book. It consists of a bundle of rights which can be dealt with separately, as correctly stated in the Annex on Copyright in the discussion draft. The main right is the right of reproduction, i.e. to make copies. Merely reading a book does not infringe the copyright. However, copyright law does define how much of a book can be copied and for what purpose. Acquisition of a book does not entail any rights in the copyright of the literary work embodied in it.

The legal position is the same for a computer program, but a distinction arises from the different ways in which a program is physically embedded and can be used. Many products include programs embedded for the purposes of the functioning of that product. Generally in such cases, the copyright is protected by technological means which prevent or impede copying. These technological protections of copyright are in many countries backed by law. Hence, the acquisition of a physical product containing a computer program embodied in this manner does not entail any rights in the copyright. However, programs designed and intended to be operated on a device controlled by the user do entail making a copy on the device, and hence the uses to which they may be put are governed by copyright. It is in this sense that the term software is commonly used. A sale of software is different from the purchase of a physical item that contains an embedded program for its functioning (e.g. an automatic timer).[6] What is granted is specific rights to use the copyright, creating a continuing relationship between the supplier and user. This is expressed legally as a license, like a lease of property, rather than an acquisition.

A purchaser may acquire the copyright in a computer program, e.g. for bespoke software. Such an outright purchase should not be regarded as a payment for rights to *use* the copyright work, but a transfer of it.

Most frequently, rights in the copyright of a program are only licensed to the user, and subject to conditions. Even the purchase of a copy of software intended to be installed and operated on a user's computer or other device can be subject to conditions on use, e.g.

[6] This point is made in the discussion draft, and in the OECD Commentary, but is misleadingly treated in terms of whether the device is a computer.

regarding the number of devices on which it can be installed. Programs designed to run an application on a computer are frequently supplied gratis to users for download. The owner of the copyright rights nevertheless retains control over them. This extends to the right to withdraw permission to operate the program, which can be enforced remotely over the internet. Applications are frequently modified or even removed by the copyright owner, sometimes without requesting permission from or even notifying the user, though this is more difficult for programs that are sold embodied in physical form.

This type of supply of software applications can be for two main purposes. One is to facilitate the operation of the physical product or hardware on which they are designed to be installed. The second is to enable the supply of digitalised services. In the latter case, payments made by using the application are not consideration for its use, but for the supply of services which it enables. Hence, they do not constitute royalties. At present they are taxable under tax treaties only as business profits, but would be covered by the proposal under discussion in the Committee for a new article 12B on taxation of automated digital services. This should include payments to access copyright works, such as listening to audio or viewing a movie. Although in some cases this may involve a temporary copy being made by the receiving device, this is not under the control of the user and should not be considered a grant of rights in the copyright.

In some cases, it may seem difficult to determine whether a payment is made for the rights in copyright of software or for the hardware on which it is embedded, or on which it is intended to operate. The purchase of many physical devices, including computers, may include the supply of a disc containing software for the device, although this is nowadays most frequently done by download over the internet. In such cases, the payment can usually be characterised as being for the hardware and not for the software. This will be so particularly for one-off payments, since payments for a licence will be recurring. This may apply also to software that is bought separately from a hardware product or device, although it must be copied onto it, if its purpose is essentially to enable the functioning of that product or device. The issue here, however, is the characterisation of the transaction. This can be done as a matter of domestic law. It should not be used to create a distinction between copyright in a computer program and in other types of works.

4. PROBLEMS WITH THE DISCUSSION DRAFT

The draft has several interrelated failings:

> (i) it is based on and perpetuates a confused and misleading explanation of copyright in the OECD Commentary;
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> (ii) it would have retroactive effect and deprive non-OECD members and other states of the right to reject the application of the OECD interpretation to the existing article 12 in actual treaties;
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> (iii) it separates categories which overlap, creating potential confusion, which is not adequately dealt with in the draft Commentary, and
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> (iv) it would limit the types of payment for rights in copyright works which might be treated as royalties, in particular payments for the right to distribute to the public.

(i) The need for these proposed changes arose from revisions of the Commentary to the OECD model convention in 1992, further revised in the 2000 update. These introduced a restrictive interpretation of the phrase ‘for the use of, or the right to use, any copyright of literary, artistic or scientific work’ in article 12 paragraph 3. While it accepted that computer programs are generally considered copyright works, it limited the rights in copyright for

which payments could be treated as royalties, by excluding the right to operate a computer program, and rights of distribution. This was based on a confused and misleading explanation of the nature of copyright in a work.

The draft would perpetuate this mistake. Although it includes 'computer software' in 3(a), it would be a distinct category (a)(iv), separate from copyright works in (a)(i). The interpretation of (a)(i) would still follow that of the OECD, and the draft includes the relevant sections of the OECD Commentary.

(ii) These same sections were also previously included in the UN model of 2011. However, the UN Commentary also included the following statement:

> 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.

The omission of this statement would have a retroactive effect on the interpretation of these existing treaties, and deprive non-OECD members and other states that rejected the OECD view of the right to maintain their interpretation. This would result from the proposed rewording of paragraph 3, as well as the omission from the draft revised Commentary of the above-cited dissent of some members from the OECD view on royalties for computer programs.

(iii) The separation of the categories creates problems of overlap. Some of these are discussed briefly in draft paragraph 20 of the Commentary, but not resolved. This will create considerable uncertainty.

(iv) The draft provides new commentary for (a)(iv). It suggests that the application of this provision would be limited to 'direct payments for computer software'. This requires a definition of 'computer', which is a difficult task, and likely to become even more so. For example, is an autonomous self-guiding device (a robot) a computer? The discussion in draft paragraph 17 of the Commentary does not attempt to define the term 'computer', yet the application of the proposed (a)(iv) would depend on this term. It is already difficult to define what is a computer, and this will undoubtedly become more so. The scope of application of article 12 should not depend on defining the term 'computer'.

Indeed, the Commentary shifts to a discussion of what constitutes a 'direct' payment, by referring to the 'fundamental purpose of the transaction'. We agree that this should be relevant, but it relates to the nature of the payment. This explanation in draft para. 17 would also be the basis for determining whether additional rights in the copyright of software are in scope, particularly the right to distribute to the public. It suggests that 'payments under arrangements that include licenses to reproduce and distribute to the public software incorporating a copyrighted program, or to modify and publicly display the program' would be included in the definition of royalties under the proposed 3(a)(iv). On the other hand, rights to distribute to the public would not be included in the proposed separate provision 3(c) which would cover 'the acquisition of any copy of computer software for the purposes of using it'.

The approach we propose, which is firmly based in the concept of rights in copyright, would be far simpler. It would treat as royalties all payments that can be considered as being for rights in the copyright of software. Where software is embedded in hardware, the question of what rights are acquired would be governed by copyright law (as is the case for other copyright works, e.g. a book). In particular, rights of resale or distribution would depend on the doctrine of 'exhaustion' in the relevant copyright law, helpfully discussed in the Annex.

Further limitations on its potential scope should be based on the nature of the payment. For example, when a copy of a program or software is acquired embedded on hardware in a way that allows use of rights in the copyright (e.g. by installing it in hardware), the payment may be considered as being for the hardware, while the rights in the software are supplied gratis. This would be equivalent to the free download of software supplied over the internet, which also includes the grant of copyright rights to install it. This would be the best way to deal with the possible problems of sales to individual consumers and potential practical difficulties of collecting withholding tax on them, discussed in the draft. However, this should be left for determination under the domestic law of the state concerned.

5. DRAFT COMMENTARY

To assist the Committee in evaluating our proposal, we provide the following draft for accompanying changes to the Commentary. Although it incorporates some parts of paragraph 12 of the OECD Commentary, the changes are so extensive that those parts are not inserted as quotations.

Paragraph 3

12. This paragraph ~~reproduces~~ ***corresponds to*** Article 12, paragraph 2, of the OECD Model Convention, but***, as explained below, includes specific references to films or tapes used for radio or television broadcasting, and to computer programs and software, which are not referred to in the OECD definition, and*** does not incorporate the 1992 amendment thereto which eliminates equipment rental from 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. 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 paragraph contains a definition of the term "royalties". These relate to payments for the use of, or the right to use, the copyright in the different types of works protected by copyright, and the different types of intellectual and industrial property specified in the text, whether or not they have been or are required to be registered in a public register, as well as for the use of, or the right to use, industrial, commercial or scientific equipment. The definition covers both payments made under a lease or licence and compensation which a person would be obliged to pay for fraudulently copying or infringing the right. As a guide, certain explanations are given below in order to define the scope of article 12 and its relation to other articles of the Convention.***

12.1. 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 12A. Payments to rent cinematograph films should also be distinguished from income from the provision of a digital service allowing users to access and view movies, which would be subject to the provisions of article 12B, as well as articles & or 9.

12.2 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).

> 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 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 of Experts 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. The OECD Commentary then continues:

> 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 formulae granted to the licensee and that he does not guarantee the result thereof.
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> 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 or in the case of the United Nations Model Convention Article 14.
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> 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:
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> - Contracts for the supply of know-how concern information of the kind described in paragraph 11 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.

12.3 In 2021 the Committee of Experts agreed to amend paragraph 3 to include a specific reference to a computer program and software in the examples of copyright work payments for which may also be considered royalties. This was done for the avoidance of doubt and not as a new provision extending the scope of article 12. Computer programs are protected by copyright in almost all countries, particularly due to the obligation in s.10 of the Agreement on Trade Related Property Rights (TRIPs) of 1995, which is binding on all members of the World Trade Organisation. Since computer programs have been given this protection as such, it does not matter whether they are regarded as literary, artistic or scientific works. The term software refers to the entire set of computer programs and instructions that enable a computer or other device to run, as opposed to its hardware. A computer program consists of instructions transmitted electronically. However, it needs to be fixated in a physical medium, especially to operate. A distinction must be made between the physical medium in which a copy of a computer program is embodied, most commonly a computer chip or a disc, and copyright in the program. Copyright controls the uses that can be made of a copy of a work, particularly the right to make copies. Hence, a payment will represent a royalty if it is in consideration for the use of a copy of a program in a manner that would, without such a license, constitute an infringement of copyright.

12. 4 When consideration is paid for the transfer of the full ownership of the entirety of the rights in the copyright, the payment cannot represent a royalty and the Article is not applicable. This would be the case, for example, for the acquisition of bespoke software. The essential character of the transaction as an alienation is not altered by the form of the consideration, or the payment of the consideration in instalments. Nor is it affected by whether the transfer is described as a transfer of copyright, provided that it includes exclusive rights in all the rights protected by copyright, and in perpetuity. However, these need not be the worldwide rights, provided they apply to the whole territory of the state concerned and in perpetuity.

12.5 Payments for rights in the copyright include any consideration for rights to distribute the program or software. When copies of a program are acquired embodied in a physical medium it is necessary to determine whether the payment is for the physical medium, or for rights to distribute the program or software, discussed further in 12.6 below. If the resale of the physical medium which embodies a copy of a computer program is not considered an infringement of copyright in the country concerned (e.g. under the principle of exhaustion) then no rights in copyright are involved in the original acquisition.

12.6 Whether a payment in connection with the acquisition of a copy of a computer program or software constitutes consideration for rights in copyright depends first on whether the use made of that copy is protected by copyright. Many products now include copies of computer programs embedded for the purposes of the functioning of that product, for example an automatic timer. Generally, copying or other infringements of copyright are prevented or impeded by technological means, often backed by law, so no rights in copyright are acquired. The acquisition of a program or software designed and intended to be operated on a computer or other device controlled by the user generally entails rights in copyright, i.e. to copy it onto the device. The acquisition may be by electronic means (download), or on a physical medium (e.g. a disc). The making of a copy for personal use

may be a permitted use under the law of the country concerned, hence no right in copyright is involved.

12.7 It must secondly be determined whether the payment can be considered to be for rights protected by copyright. A computer program or software application may be supplied for no payment. For example, it may be designed and intended to enable the supply of services by digital means. In such cases, payments made by using the application are not consideration for its use, but for the supply of services which it enables. Hence, they do not constitute royalties. They may be taxable as business profits under articles 7 or 9, as fees for technical services under article 12A, or as automated digital services under article 12B. This includes payments to access copyright works by using the application, such as listening to audio or viewing a movie. Although in some cases this may involve a temporary copy being made by the receiving device, this is not under the control of the user and should not be considered a grant of rights in the copyright. Secondly, a computer program or software may be supplied together or in conjunction with the sale of a physical product or device, and designed and intended to operate as part of the functioning of that device. Examples are the operating system of a computer or device, and programs or software for a 'smart' device such as a television. In such cases, the nature of the payment depends on whether the transaction should be characterised as being essentially a sale of the hardware, or a license for the use of the program or software. A relevant factor in characterising the transaction is whether recurring payments are required or envisaged for the operation of the program or software. Where the initial acquisition of rights in the program or software takes place in conjunction with acquisition of the hardware, but continuing payments relating to the software are involved, the transaction may be characterised as a mixed contract, and the methods set out above for dealing with similar problems in connection with franchising are equally applicable in this context. The issue here is the characterisation of the transaction, which is a matter of domestic law.