

Committee of Experts
on International Cooperation in Tax Matters
11th Session: Geneva, 19-23 October 2015

Agenda Item 3(a)(v): Article 12 (Royalties)

Aim of CRP.7

- Clarify the meaning of “industrial, commercial and scientific equipment” (“ICS equipment”)
- Deal with the issue of coverage or otherwise of software-related payments
- Definition of ICS equipment
- Difference: lease and sale
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1) Definition of ICS equipment

13.1

2) Difference between lease and sale

- Premises:
 - Art 12 does not apply to transfer of ownership
 - Distinction – especially in leasing cases – not always easy
 - Leasing contracts often combine lease and sale element
 - Hence, guidance welcome
- Proposal: Add paragraph to Commentary (see CRP.7 para. 29)
 - Adapted version of former OECD paragraph
 - Financial lease = sale
 - Operating lease = lease
 - Decisive factor: true legal import vs. economic substance
 - Catalogue of factors
 - Disadvantage: Limits leeway in application

3) Treatment of transmission capacity

- Use of transmission capacity
use of equipment
 - Reasons:
 - No physical possession of equipment
 - Term “use” suggests positive act of utilization
 - Rather service provided to payer by the owner
 - Suggestion:
 - Include OECD (and possibly, dissenting) view in Commentary (see CRP.7 para 43)
- Use of transmission capacity =
use of equipment
 - Reasons:
 - Notion of use does not require physical possession and control
 - Concept is alien to other items covered by Art 12(3)
 - Suggestion:
 - Include provision reflecting this view in Commentary (see CRP.7 para 42)
 - (Diligence re relation to provision of services required)

4) Relation between Art 8 and Art 12

- Premise: Aircraft, ships and containers are covered by Art 8 and Art 12 → potential for conflict
- Solution: 41 -1.43 TD0 Tc0 Tw()Tj23fxp225
Art 12 →

5) Inclusion of software in Art 12(3)

- Current treatment:
 - Source: Paras 14-14.2 OECD Commentary on Art 12; incorporated into UN Commentary
 - Dissenting opinion re relevant paragraphs also incorporated into UN Commentary
 - Distinction → difficult!
- Radical approach: Inclusion of software into Art 12(3)
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Conclusion

- Several “areas for action” re ICS equipment and software
 - Definition of ICS equipment
 - Difference: lease and sale
 - Treatment of transmission capacity
 - Relation: Art 8 and Art 12
 - Inclusion of software in definition of royalties
 - Clarify reasons for dissenting views
- Each needs careful discussion among Committee Members

CRP.7 paragraph 29 (cont'd)

Indications for a finance lease rather than an operating lease might include, for example:

- the lease is long term and non-cancellable;
- the term of the lease is likely to cover a substantial part (or all) of the equipment's useful life;
- there is no other user of the equipment, or it is not feasible for the equipment to be leased to another lessee;
- the lessor of the equipment behaves as owner;
- the lessor carries positive and/or negative residual value risk in respect of the equipment;
- the leasing rates are so high at the beginning that they constitute an inordinately large proportion of the amount needed to secure the acquisition;
- payments materially exceed the current fair rental value and thus compensate for more than just the use of property; and
- some portion of the payments is specifically designated as interest or is otherwise readily recognizable as the equivalent of interest.

CRP.7 paragraph 42: Alt' view on treatment of transmission capacity

A payment can be said to be “for the use of, or the right to use, industrial, commercial or scientific equipment” if the payment is made for availing of the capacity and functions of a certain item to the payer.

Alternative

A payment can be said to be “for the use, or the right to use, industrial, commercial or scientific equipment” if the payment is made for availing of the capacity and functions of a certain item to the payer unless the payment is made to the payee for the use of equipment by the payee for providing services to the payer. The distinction will depend on the involvement of the payee in the arrangement and if possible, the arrangement could be separated into a service and an equipment use component.

CRP.7 paragraph 43: Dissenting view on OECD view

Paragraphs 13.3-13.5 reproduce the view of the OECD Commentary on the treatment of satellites, cables for the transmission of electrical power or communications, pipelines and similar types of equipment (see paragraphs 9.1-9.3 of the OECD Commentary in article

CRP.7 paragraph 53/56: Possible changes to Article 12

_____, royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

ALTERNATIVE

3. The term “royalties” as used in this Article means

(a) 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 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 information concerning industrial, commercial or scientific experience; and

(b) payments of any kind received as a consideration for the use of, or the right to use, industrial, commercial or scientific equipment _____

_____ payments derived by an enterprise described in paragraph 1 of Article 8 (Shipping, Inland Waterways Transport and Air Transport).

