

# United States: Australia's Draft Ruling on Treatment of Software Payments as Royalties Could Lead to Treaty Disputes

17 February 2023

Report from our correspondent Jannica Robles Santos, J.D.

The United States has raised concerns on a draft ruling, issued by the Australian Taxation Office, which classifies certain payments for computer software as royalties (see [Australian Taxation Office Consults on Definition of Royalties \(28 June 2021\)](#)). In a letter to the Australian authorities made public by the US Department of Treasury on 14 February 2022, the Department's Office of International Affairs said that the preliminary views found in the draft ruling, if applied by Australia to interpret the [Australia-United States Income Tax Treaty \(1982\)](#), could lead to treaty disputes.

More specifically, the letter cited two examples found in the draft ruling, wherein the ATO concluded that the payments made by the Australian company to the owner of the software, which is a non-Australian parent corporation, are royalties even though neither the Australian company nor the customers have the right to reproduce or modify the software nor any other right of the software owner. According to the letter, because the examples "involve solely the right to distribute copies of the software, without the right to reproduce or modify the software or any other right of the software owner, the interpretation that the payments are royalties would be contrary to long-standing internationally accepted treaty interpretation, including [paragraph 14.4 of the Commentary to Article 12 \(Royalties\)](#) of the [OECD Model Tax Convention](#), which is also endorsed in the United Nations Model Tax Convention." The letter added that the interpretation that the payments are royalties would "create a concerning imbalance in the benefits provided by the US-Australia tax treaty" because under the US Treasury regulations, such payments are treated as payments in exchange for services, rather than royalties.