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Taxation of standard software - an overview

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The Portuguese Tax Administration (PTA) recently concluded that payments received for the sale of 'standard software' (ie, software not subject to any customisations) do not fall within the scope of the observations made by Portugal to the Commentaries on Article 12 of the Organisation for Economic Cooperation and Development (OECD) Model Convention. Instead, the right to tax income deriving from such payments falls within the purview of the beneficiary of such payments' state of residence under Article 7 (business income) of the OECD Model Convention.

Object of the binding information

Under the terms of the relevant binding information, the PTA aimed to answer the following questions raised by the taxpayer:

- Are payments made for the sale of standard software products by an Italian company to a Portuguese taxpayer subject to Portuguese withholding tax?
- Are monthly payments made for the use of a standard software licence by an Irish company to a Portuguese taxpayer subject to Portuguese withholding tax?

Relevant legal framework

There is no universal agreement on the qualification of earnings derived from software. However, it is now widely agreed that the sale of standard software falls within the scope of Article 7 (business income) of the OECD Model Convention.

Under the terms of the Commentaries on Article 12 of the OECD Model Convention, the sale of standard software falls within the scope of Article 7 (business income) of the OECD Model Convention and is therefore subject to taxation in the beneficiary's state of residence.

Portugal follows this line of reasoning, but has made the following observation on the Commentaries:

The payments related to software fall within the scope of Article [12] where less than full rights to software are transferred independently on whether the payments are in consideration for the right to use a copyright on software for commercial exploitation (except payments for the right to distribute standardised software copies, excluding the right to customize or reproduce them), or in consideration for the acquisition of software for use within the activity of an undertaking, provided on the latter case the software is not entirely standard but somehow adapted to the acquirer.

PTA decisions

The PTA found in both of the above queries that Article 12 of the convention between Portugal and the second state did not apply, since the earnings obtained derived from the sale of standard software or licensing for the use of standard software. Thus, both cases fell within the scope of Article 7 (business income) of the relevant convention.

Since the foreign companies in both instances did not have permanent establishments in Portugal, the PTA concluded that the profits obtained with reference to these transactions would not be liable to withholding tax in Portugal.

For further information on this topic, please contact [António Fernandes de Oliveira](#) or [Mónica Respício Gonçalves](#) at AFDO-adv? by telephone (+351 919 118 692) or email (a.fernandesdeoliveira@afdo-adv.com or m.respiciogoncalves@afdo-adv.com). The AFDO-adv website can be accessed at www.afdo-adv.com.

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AFDO-adv - António Fernandes de Oliveira, Mónica Respício Gonçalves

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