The Tax Institute

22 September 2025

Mr Tim McCarthy
Assistant Commissioner
Public Groups and International
Australian Taxation Office

By email: IntangiblesArrangements@ato.gov.au

Dear Mr McCarthy,

Draft Practical Compliance Guideline (PCG 2025/D4): Low-risk payments relating to software arrangements – ATO compliance approach

The Tax Institute welcomes the opportunity to make a submission to the Australian Taxation Office (**ATO**) in respect of its consultation on PCG 2025/D4: *Low-risk payments relating to software arrangements – ATO compliance approach* (**draft PCG**).

In the development of this submission, we have closely consulted with our National Large Business and International Technical Committee to prepare a considered response that represents the views of the broader membership of The Tax Institute.

We have outlined our observations and comments below for your consideration to improve the current version of the draft PCG.

Early release of the draft PCG

The draft PCG has been published at a time when there has been great interest regarding the tax treatment of royalties among our members and the community, more broadly in light of the recent High Court decision in *Commissioner of Taxation v. Pepsico Inc. and Commissioner of Taxation v. Stokely-Van Camp Inc.* [2025] HCA 30 (**PepsiCo HCA decision**). Given the importance of that decision to the subject matter of this draft PCG, some of our members have remarked on the fact that the draft PCG was published on 6 August 2025, a week before the PepsiCo HCA decision was handed down.

We acknowledge that the ATO must administer the law as it currently stands, but the ATO regularly delays adopting or changing a position subject to the outcome of court appeals so as to take into account the legal guidance provided by the courts.

Paragraph 3 of the draft PCG makes it clear that it must be read in conjunction with TR 2024/D1 *Income tax: royalties – character of payments in respect of software and intellectual property rights* (**TR 2024/D1**), and at paragraph 5 it confirms that TR 2024/D1 would be reviewed pending the PepsiCo HCA decision. Clearly, that decision was bound to have a significant impact on the administration of this area of taxation law.

We consider that it would have been more appropriate to defer the release of the draft PCG until after the PepsiCo HCA decision. Firstly, this might have saved valuable time. Stakeholders are keen to provide feedback on the draft PCG and will need to engage in further consultations assuming the draft PCG is revised in light of the PepsiCo HCA decision. Early release of the draft PCG creates the potential for unnecessary duplication of effort.

We are also concerned that this process could give rise to negative perceptions regarding how the ATO treats the outcome of court decisions. A perception that the ATO may make decisions irrespective of the outcome of a court case, particularly the highest Australian court, could undermine confidence in the administration of our tax system. It was clear when the draft PCG was published that the PepsiCo HCA decision was pending, and that this decision would have important consequences for the subject matter of the PCG – royalties. We are unclear as to the benefits of proceeding with the publication of the draft PCG prior to that decision being handed down. Feedback from our members indicates that releasing a draft PCG on a topic that is subject to a high-profile appeal shortly before that decision is handed down has caused some confusion.

Acknowledging that the draft PCG has been released for consultation, the above comments are provided to offer constructive feedback, which we trust will be taken into account in managing future consultations.

Examples

The examples presented in the draft PCG only cover very straightforward and non-controversial scenarios. The draft PCG does not cover arrangements that exist outside the specified low-risk zone. We acknowledge the comment made at paragraph 4 that the ATO may, at a later stage, expand the PCG beyond low-risk cases. However, the current approach significantly limits the usefulness of this draft PCG to taxpayers. Feedback from our members suggests that the ATO has made a commitment to clarify apportionment and evidentiary requirements. However, these essential topics are not addressed in the draft PCG. Consequently, there is considerable uncertainty for taxpayers regarding the ATO's approach to more complex software-related arrangements. We consider that further work is required to review and expand the draft PCG to give a clearer indication of the ATO's compliance approach beyond the low-risk zone. Doing so would make the draft PCG more practical and useful for taxpayers.

Interaction of the draft PCG with TR 2024/D1

The Tax Institute has previously made the following submissions on software royalties, which should be read together to understand our considered view on the issue:

- submission to the ATO consultation on TR 2024/D1; and
- submission to the ATO consultation on TR 2021/D4.

The Tax Institute is of the view that the Commissioner's liberal interpretation of copyright and other intellectual property (**IP**) laws in TR 2024/D1 is incorrect and inconsistent with established jurisprudence on royalty. While we do not necessarily agree with some of the views expressed in TR 2024/D1, we have provided the following comments on the assumption that TR 2024/D1 continues to reflect the ATO's position.

TR 2024/D1 outlines a number of payments that will be characterised as a royalty (at paragraph 14) and a number that will not be characterised as a royalty (at paragraph 15).

The draft PCG includes examples in the green zone:

- for the distribution of finished tangible goods with embedded software (dot point 3 in paragraph 27 and example 4 of the draft PCG) that aligns with paragraph 15(c) of TR 2024/D1 (and would distinguish paragraph 14(e) of TR 2024/D1); and
- for the distribution of software on physical media (dot point 4 in paragraph 27 and example 3 of the draft PCG) that aligns with paragraph 15(d) of TR 2024/D1.

It would be helpful if the draft PCG expands the green zone to include examples of the types of arrangements covered by paragraphs 15(a) and 15(e), which would help distinguish those arrangements from those covered by paragraph 14 and the scenarios in TR 2024/D1.

In this regard:

- TR 2024/D1 indicates that a payment is not a royalty where it is consideration wholly for the grant of a right to distribute copies of a computer program without the use of, or right to use, the copyright or another IP right (at paragraph 15(a)). Particularly in the context of the scenarios included in TR 2024/D1, it would be helpful for the draft PCG to include an example of the type of arrangement the ATO would consider to be in the green zone, where the arrangement is not already covered by the distribution of software on physical media; and
- TR 2024/D1 also indicates that a payment is not a royalty where it is consideration for the provision of services that are unrelated to any IP right referred to in paragraph (a) of the standard tax treaty definition or any knowledge or information mentioned in paragraph (b) of the standard tax treaty definition (paragraph 15(e)). It would also be helpful if the draft PCG includes an example of arrangements that would fall within the green zone for these types of arrangements.

Furthermore, the 'green zone' examples in the draft PCG appear to reintroduce the concept of 'simple use', which was previously used in the software ruling TR 93/12. It would be useful if this concept were reintroduced more explicitly in both TR 2024/D1 and the draft PCG.

If you would like to discuss any of the above, please contact The Tax Institute's Tax Counsel, John Storey, on (03) 9603 2003.

Yours faithfully,

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