The attached note is submitted to the Working Party FOR DISCUSSION at its meeting on 18-20 September 2000.

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SUMMARY/ACTION REQUIRED

This note includes the latest draft of the document "General Conclusions on Treaty Characterization Issues and Analysis of Typical E-Commerce Transactions" that has been circulated for discussion by the TAG on Treaty Characterisation of Electronic Commerce Payments. The TAG has requested that comments be made by 13 October 2000. It intends to finalise its report to the Working Party No. 1, in light of comments received, in early November when it meets in Mumbai (India).

This note is to be discussed at the September 2000 meeting of the Working Party No. 1.
Introduction

1. The OECD Committee on Fiscal Affairs (CFA) has undertaken a major consideration of the taxation issues raised by e-commerce and its underlying technologies. The OECD has recognized that the input of the business community and economies outside of the OECD area are an essential element of its deliberations on this issue. The CFA, through its subsidiary bodies, has therefore engaged in a broad consultation process with the business community and non-OECD economies. This process has been carried out primarily through the use of Technical Advisory Groups (TAG).

2. On 24 March 2000, one of these TAGS, the TAG on Treaty Characterization of Electronic Commerce Payments, released for comments a document describing 26 categories of e-commerce transactions and presenting the preliminary conclusions of the Group, and their underlying analysis, on how the payments arising from these transactions should be classified for tax treaty purposes. Interested parties were invited to send their comments on that proposal before 31 May 2000.

3. The TAG wishes to thank the individuals and organizations who have sent comments on the document released in March. At its meeting of 3-4 July, the TAG has pursued its work on the basis of these comments. This has allowed the TAG to narrow down areas of disagreement between its members, to revise its list of transactions and to draft some general conclusions on treaty characterization issues. The results of that work are included in the attached document, which the TAG has decided to release for further comments.

4. The TAG will meet once more in Mumbai (India) at the beginning of November. It then intends to finalize its report to Working Party 1 and the Committee on Fiscal Affairs in light of the comments received, so as to complete its work before the end of the year.

5. Comments on the attached document should be sent before 13 October 2000 to:

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TAG ON TREATY CHARACTERIZATION ISSUES ARISING FROM E-COMMERCE:
GENERAL CONCLUSIONS ON TREATY CHARACTERIZATION ISSUES AND
ANALYSIS OF TYPICAL E-COMMERCE TRANSACTIONS

Introduction

6. On 24 March 2000, the Technical Advisory Group on Treaty Characterization of Electronic Commerce Payments released for comments a document describing 26 categories of e-commerce transactions and presenting the preliminary conclusions of the Group, and their underlying analysis, on how the payments arising from these transactions should be classified for tax treaty purposes.

7. At its meeting of 3-4 July, the TAG continued its work on the basis of these comments, which are summarized in section 1. This has allowed the TAG to narrow down areas of disagreement between its members, to revise its list of transactions and to draft some general conclusions on treaty characterization issues. The results of that work are included in sections 2 and 3 of this document, which the TAG has decided to release for further comments. Section 2 describes the various treaty characterization issues that were identified by the Group and present the views of the Group concerning these issues. Section 3 is a revised version of the document released on 24 March, which now includes a revised analysis of 27 categories of typical e-commerce transactions.

8. Throughout its work, the Group has assumed that all payments made in connection with the various transactions identified were received in the course of carrying on a business, whether or not the payers were themselves carrying on business. It follows that all these payments are capable of falling within Article 7 of the OECD Model Tax Convention, which deals with business profits. Some payments, however, may be taken out of Article 7 by the rule of paragraph 7 of Article 7, which gives priority to any other Article that expressly deals with the specific type of income concerned. One such Article is Article 12, dealing with royalties. On the basis of its analysis, the Group does not consider that any of the payments that it has examined fall within Article 21, which deals with other income.

SECTION 1. SUMMARY OF COMMENTS RECEIVED

9. The following summarizes the various comments that the TAG has received on the draft that it made public on 24 March 2000.

General comments

10. One commentator suggested that "since the work of the TAG is ultimately directed primarily to the question of whether and how the Model Treaty Commentary should be expanded or modified, […] the discussion of treaty language not found in the current OECD Model Treaty should be eliminated from future discussion drafts published by the TAG. After discussion, the Group decided not to follow that suggestion since its mandate clearly requires it to examine characterization issues arising from provisions different from those of the OECD Model.

11. Also, one commentator recommended that one more category be added to the list of transactions, namely the payment of carriage fees, which he described as follows: "Example 25 in the Draft for Comments describes a situation where a web site operator pays content providers for information, stories, and data to be carried on its web site. The reverse of this transaction is also very common. Namely, content providers often pay web site or network operators in order to have their content displayed by the web site.
or network operator. In this situation there is no question of the website or network operator being compensated for a copyright or other item of intangible property. Instead, the website or network operator is providing a commercial service for a fee and its income should be characterized as business profits under Article 7 of the Model Treaty.” The Group adopted that suggestion (see category 27 in section 3 below).

Category 2 – Electronic ordering and downloading of digital products

12. The vast majority of comments received have dealt with the characterization issue raised by the downloading of digital products. All the comments that have been received on the diverging views reflected on that issue have been in support of the majority view. The following points were stressed in these comments:

- A few commentators referred to the incidental nature of any copying done in that type of transactions, noting that "the copying of a product onto the customer’s hard drive or other similar media is simply an essential but incidental step in the main transaction".

- A number of commentators referred with approval to the recently adopted changes to the Commentary on Article 12, noting that the majority view was consistent with the revised Commentary on Article 12 which states that the method of transferring a computer program is not relevant. Many of them indicated that there was no reason why other electronic products should be treated differently from software. It was also stated that it was fundamental not to reopen the discussion on these Commentary changes. Finally one commentator referred specifically to paragraph 14.2 of the revised Commentary, suggesting that the TAG should extend the principle of that paragraph to all digital products and that the minority should confine its position to those cases where no intermediate storage device is delivered to the customer.

- Many commentators raised the issue of neutrality between forms of doing business, concluding for instance that "in order to avoid unjustified discrimination, e-commerce payments should be characterized, wherever possible, in a manner similar to their already existing off-line counterparts. Accordingly, revenues from the mere selling of digitised products on-line cannot be characterized as royalties.” Similarly, a number of commentators have argued that the minority view is contrary to the Framework Condition that taxation seek to be neutral between conventional and electronic forms of commerce.

- Two commentators have suggested that the definition of royalties has traditionally been applied to cases where the transfer of a right to use someone else’s copyright was made for the purpose of commercial exploitation. One of them has argued that "the proposition that royalty characterization should arise only in cases where there is a transfer of copyright that authorizes commercial exploitation of the right by the transferee is well founded and consistent with the current practice regarding off-line transactions" while the other has indicated that "this commercial exploitation standard articulated in paragraph 13 of the existing Model Treaty commentary provides a useful practical guide for distinguishing between those situations where payments for limited rights in software and other digital information should be treated as royalties, and those situations where such payments should be treated as business profits.”

- One commentator challenged the minority position by applying it to the delivery of a digital product on a tangible medium, noting that "the fundamental nature of both the electronic delivery transaction and the transaction which uses an intermediate storage device are the same. […]" The minority view assumes that in the electronic delivery model, the payment is
made almost exclusively for the right to make the copy to the hard disk. However, we believe that existence of this right is no less important in transactions where the digital product is delivered on an intermediate storage device. While it might be possible for a customer to use a digital product without loading a copy on the hard disk, the customer would be placed in the situation that existed prior to the advent to the hard disk. [...] In this day and age, most users of digital products would shun products that did not grant them the right to make a copy to their hard disk. From a practical standpoint, the right to copy digital products to hard drives is as important to the electronic delivery model as it is to the intermediate storage device deliver model. There is no difference between the two models sufficient to drive a difference in tax treaty characterization of the respective payment.”

− The same commentator has also challenged the assumption, by the minority view, that the customer is always making a payment primarily for the right to make a copy to a computer hard disk: "We believe that there are everyday situations where this presumption may not hold true. For instance, a digital product vendor may make a product available for download to the general public. However, the product is locked; that is, the copy that the potential customer can download and store on the computer’s hard disk is unusable. In order to make the digital product usable, the customer must pay the vendor and obtain an access code which, when entered into the computer, authorizes full functionality. [...] would the minority, on the scenario described in the preceding paragraph, conclude that the payment should continue to be characterized as a royalty under Article 12 of the Model Treaty? We believe that these facts would indicate that the payment is not made for the right to copy because, at the time the copy was made, no payment was due.”

− Another commentator raised the argument of practicality, arguing that "the majority position represents the only workable approach to the characterization issue. In the normal operation of a computer a certain amount of copying of operating software, applications software and other digital products takes place. [...] Thus, the minority position appears to require that some copying gives rise to royalty treatment while other copying does not. [...] serious tax enforcement confusion would be created by the promulgation of Model Treaty commentary suggesting that the essential test is one of determining whether copying of copyrighted material stands on its own, or is instead incidental to other activities. A hallmark of successful income characterization rules is that they are easily applied to yield clear answers. We believe that the commercial exploitation standard articulated in the existing Model Treaty commentary is such a rule and should be adopted. A test requiring a determination in each instance of whether copying is “essential” or “incidental” would not create clear lines of demarcation and should therefore be avoided.”

**Category 5 – Limited Duration Software and other Digital Information Licences**

13. One commentator expressed support for the majority view expressed on that category, i.e. that a payment for the transfer of limited duration software cannot be considered to be a “payment for the use of, or the right to use, industrial, commercial or scientific equipment”. That commentator first remarked that such software cannot be considered to be "equipment", noting that "the fact that the product is provided on a tangible medium does not alter the fact that what is actually being provided is the digital content and not the tangible medium itself”. The commentator added that "whether the words 'industrial, commercial or scientific' can apply to such transactions must be assessed from the recipient’s point of view. For example, if it is music, games, videos or similar products provided to a private consumer, it could not be seen as industrial, commercial or scientific in nature”. Finally that commentator discussed the requirement that the payment be “for the use of, or the right to use” the product and expressed the view that there would be a
difference between a product acquired for a certain period, being less than its useful life, and a product that has an inherently short useful life.

Category 10 – ASP License Fees

14. One commentator indicated that the facts of the example given for category 10 were ambiguous in that it seemed that the ASP was making the software directly available to its customers, which could constitute a sub-licensing of the software so as to trigger the application of Article 12. As noted by the commentator, the right to publicly display or publicly perform software also are copyright rights. The commentator asked that the example be clarified in that respect, a suggestion that was adopted by the Group.

Category 25 – Content Acquisition Transactions

15. One commentator expressed support for the conclusions expressed in respect to that category, i.e. that the two alternatives described in the definition in paragraph 25 require different tax treatments.

SECTION 2. TREATY CHARACTERIZATION ISSUES ARISING FROM E-COMMERCE TRANSACTIONS

16. This section describes the various treaty characterization issues that were identified by the Group in the course of its work and presents the views of the Group concerning these issues.

Business profits and royalties

17. The definition of royalties currently found in paragraph 2 of Article 12 of the OECD Model Tax Convention reads as follows:

"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 cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience."

18. In the 1977 Double Taxation Convention, that definition also included "payments [...] for the use, or the right to use, industrial, commercial or scientific equipment" and some bilateral conventions still include this previous definition of royalties.

19. This section analyses classification issues arising from the possible application of various elements of these two definitions to payments made in e-commerce transactions.

Business profits and payments for the use of, or the right to use, a copyright

20. The Group found that one of the most important characterization issues arising from e-commerce was the distinction between business profits and the part of the treaty definition of "royalties" that deals with payments for the use of, or the right to use, a copyright. It spent considerable time discussing that issue, including the suggestion that royalty characterization could not arise in the absence of a transfer of rights to allow a commercial exploitation of the copyright by the transferee, but could not reach a unanimous view on all aspects of the problem.
21. The Group agreed that, in any given transaction, the main question to be addressed was the identification of the consideration for the payment. Under the relevant legislation of some countries, transactions which permit the customer to electronically download computer programs or other digital content may give rise to use of copyright, e.g. because a right to make one or more copies of the digital content is granted under the contract. The Group agreed that, where the consideration is for something other than rights in the copyright (such as other types of contractual rights or such as data or services), and the use of copyright is limited to such rights as are required to enable downloading, storage and operation on the customer’s computer or network, such use of copyright should be disregarded in the analysis of the character of the payment for tax purposes. The Group agreed that this would be the case, for instance, where a payment is made by a person for the downloading and the operation of a copy of a computer program. While electronic downloading of the program may or may not constitute the use of a copyright by the user (as opposed to by the provider) depending on the relevant copyright law and contractual arrangements, the Group acknowledged that the essential consideration for the payment is the acquisition of rights allowing the use of a copy of the computer program on the customer’s computer or network. The granting of rights in relation to the downloading and storage processes, where they do no more than enable the effective utilization of the program by the customer, would be merely an incidental and accessory part of the transaction. In this respect, the Group unanimously endorsed the conclusions expressed in paragraphs 14 to 14.2 of the recently adopted changes to the Commentary on Article 12.

22. Two different views were expressed, however, as regards the electronic download of other forms of digital products. Where a payment is made by a person for the right to download a digital product other than software (such as images, sounds or text), the majority considers that the economic substance of the transaction, and therefore the essential consideration for the payment, is the acquisition of a digital product for the own use or enjoyment of the acquiror. In that respect, they see the situation of digital products such as music, picture or movies as indistinguishable from that of computer programs.

23. For the majority, even if the act of copying the product onto the customer’s hard disk or other non-temporary media constitutes the use of a copyright by the user under the relevant law and contractual arrangements, this is merely an incidental part of the transaction that is not important for classification purposes. For both the customer and the provider, the economic substance and the purpose of the transaction, which determines the nature of the consideration for the payment, is to deliver a digital product that the customer may use and not to allow the customer to use the copyright in that product, and the method of delivery is chosen by the provider and the customer merely to create distribution cost and time efficiencies. Furthermore, treating a digital product delivered electronically and a digital product delivered on tangible medium in the same way is consistent with the framework condition of neutrality, which states that the taxation of an e-commerce transaction should not differ from the taxation of the analogous transaction in traditional form.

24. The minority within the Group, however, considers that, in the absence of any other rights granted or services provided under the contract if, under the applicable copyright law, the downloading constitutes a use of copyright by the user (as opposed to by the provider), the consideration for the payment for the right to download such a digital product can only be for the use of the intellectual property copyright that must be utilized in the downloading and storing process. The minority disagrees with the majority’s view that the purpose of such a transaction is to deliver a digital product to the customer, as the digital product for the customer’s use does not exist until it is created by the customer through an act of copying. The proponents of the minority view argue that in this type of transaction, assuming the transaction constitutes a use of copyright by the user, there is no property or service, other than the right to make the copy, that is acquired by the customer from the provider. They consider that it cannot be said that the copying is an incidental part of the transaction, as it constitutes the essence and entirety of the transaction. They conclude, therefore, that the payment is wholly for the right to copy and thus constitutes a royalty.
Business profits and payments for know-how

25. While e-commerce transactions resulting in know-how payments are relatively rare, in some transactions, it is necessary to distinguish whether the consideration for a payment is the provision of services or the provision of know-how (i.e. information concerning industrial, commercial or scientific experience).

26. The Group noted that paragraph 11 of the Commentary on Article 12 refers to the following key elements to identify transactions for the provision of know-how:

- according to the ANBPI [Association des Bureaux pour la Protection de la Propriété Industrielle], know-how is “undivulged technical information that is necessary for the industrial reproduction of a product or process, directly and under the same conditions; inasmuch as it is derived from experience, know-how represents what a manufacturer cannot know from mere examination of the product and mere knowledge of the progress of technique.”

- “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”

- in the know-how contract “the grantor is not required to play any part himself in the application of the formula ... and ... does not guarantee the results thereof”

- the provision of know-how must be distinguished from 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”

27. The paragraph also includes the following examples of payments which should not be considered to be received as consideration for the provision of know-how but rather, for the provision of services:

- payments obtained as consideration for after-sales service,

- payments for services rendered by a seller to the purchaser under a guarantee,

- payments for pure technical assistance, and

- payments for an opinion given by an engineer, an advocate or an accountant,

28. Applying these criteria and examples to e-commerce transactions, the Group agrees that, for instance, online advice, communications with technicians and using the trouble-shooting database, would clearly involve actual services being performed on demand rather than the provision of know-how.

29. The Group recognizes that the distinction between payments for services rendered and payments for the supply of know-how may sometimes raise practical difficulties. It considers that the following criteria, developed in a ruling by the Australian Tax Office, may be useful in that respect.

- under a contract for the supply of know-how:
  
  (a) a "product" (i.e. knowledge, information, technique, formula, skills, process, plan, etc.) which has already been created or developed or is already in existence is transferred;
(b) the product which is the subject of the contract is transferred for use by the buyer (i.e. it is supplied); and

(c) except in the case of a disposition where the seller divests himself completely of any further interest in the product, the property in the product remains with the seller. All that is obtained by the buyer is the right to use the product. Subject to the terms of the contract, the seller retains the right to use the product himself and to transfer it to others.

- by contrast, in a contract involving the performance of services:

(d) the contractor undertakes to perform services which will result in the creation, development or the bringing into existence of a product (which may or may not be know-how);

(e) in the course of developing a product, the contractor would apply existing knowledge, skill and expertise - there is not a transfer (i.e. supply) of know-how from the contractor to the buyer as such but a use by the contractor of his knowledge for his own purposes; and

(f) the product created as a result of the services belongs to the buyer for him to use without having to obtain any further rights in respect of the product. However, in the course of rendering services the contractor would, in most cases, also produce as a by-product a work (e.g. plan, design, specification, report, etc., - which could contain knowledge, etc. not otherwise known to the buyer and which may or may not be protected by patents, etc.) in which copyright would subsist. Unless specifically agreed otherwise, the contractor is the owner of such copyright and the buyer or any other person is, by law, precluded from using the property in which the copyright subsists for any purpose other than the purpose for which it was originally designed without first obtaining the approval of the contractor. This would not alter the nature of the contract which would remain one for the performance of services.

- another very important factor is the incidence of cost, i.e., both the level and the nature of the expenditure incurred by the seller:

(g) in most cases involving the supply of know-how which is already in existence there would appear to be very little more which needs to be done by the supplier other than to copy 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.

(h) a contract for the performance of services would, depending on the nature of the services to be rendered, involve the contractor in such items of expenditure as salaries and wages to employees engaged in researching, designing, testing, drawing and other associated activities, payments to sub-contractors for the performance of similar services, etc
these factors all point to the one main distinctive feature of know-how - that it is an asset and, as such, it is something which is already in existence and is not something brought into being in pursuance of the particular contract.  

The Group also considers that the following excerpt of the "software regulations", which U.S. IRS and Treasury issued in 1998 regarding the characterization of income from cross-border transactions involving computer programs, provides useful criteria to distinguish payments for services and payments for know-how as regards e-commerce transactions related to computer programs. Those regulations deal with the distinction between the provision of services (for the development or modification of the computer program) and the provision of know-how (relating to computer programming techniques) in the following words:

"Provision of services. The determination of whether a transaction involving a newly developed or modified computer program is treated as either the provision of services or another transaction described [above] is based on all the facts and circumstances of the transaction, including, as appropriate, the intent of the parties (as evidenced by their agreement and conduct) as to which party is to own the copyright rights in the computer program and how the risks of loss are allocated between the parties.

Provision of know-how. The provision of information with respect to a computer program will be treated as the provision of know-how . . . only if the information is

(1) Information relating to computer programming techniques;

(2) Furnished under conditions preventing unauthorized disclosure, specifically contracted for between the parties; and

(3) Considered property subject to trade secret protection."

Example . . . .

(i) Facts. Corp A, a U.S. corporation, and Corp I, a Country Z corporation, agree that a development engineer employed by Corp A will travel to Country Z to provide know-how relating to certain techniques not generally known to computer programmers, which will enable Corp I to more efficiently create computer programs. These techniques represent the product of experience gained by Corp A from working on many computer programming projects, and are furnished to Corp I under nondisclosure conditions. Such information is property subject to trade secret protection.

(ii) Analysis. This transaction contains the elements of know-how specified [above]. Therefore, this transaction will be treated as the provision of know-how."

Business profits and payments for the use of, or the right to use, industrial, commercial or scientific equipment

As already mentioned, a number of bilateral conventions include a definition of royalties that covers “payments for the use of, or the right to use, industrial, commercial or scientific equipment” even though these words are no longer found in the definition of the current OECD Model Tax Convention.  

a) Digital products

32. The Group examined a few transactions where the issue could arise whether the words “payments for the use of, or the right to use, industrial, commercial or scientific equipment” covered payments for time-limited use of a digital product (e.g. category 5 dealing with limited duration software and other digital information licenses).

33. The majority view within the Group is that payments for such use of digital products cannot be considered as payments “for the use of, or the right to use, industrial, commercial or scientific equipment” on the basis of one or more of the following reasons:

- because digital products cannot be considered as “equipment”, either because the word “equipment” can only apply to a tangible product (and the fact that the digital product is provided on a tangible medium would not change the fact that the object of the transaction is the acquisition of rights to use the digital content rather than rights to use the tangible medium) or because the word “equipment”, in the context of the definition of royalties, applies to property that is intended to be an accessory in an industrial, commercial or scientific process and could not therefore apply to property, such as a music or video CD, that is used in and for itself;

- because such products cannot be viewed as “industrial, commercial or scientific”, at least when provided to the private consumer. Based on the nature of these products or the purpose of their acquisition by the users, these members believe that products such as games, music or videos cannot be considered as “industrial, commercial or scientific”; or

- because the payments involved in that type of transaction cannot be considered to be “for the use, or the right to use” the product since these words do not apply to a payment made to definitively acquire a property designed to have a short useful life, which is the case for most of these products, e.g. where someone acquires a video game CD that is programmed to become unusable after a certain period of time.

34. A minority within the Group, however, considers that, in some very limited circumstances, payments for the time-limited use of a digital product may be considered to be "for the use of, or the right to use, industrial, commercial or scientific equipment". This would be the case only if the following conditions were met:

- the digital product is provided on a tangible medium, as opposed to being downloaded (those who adopt that view consider that the word equipment is broad enough to apply in that case as they consider that the equipment is the medium from which the digital content is inseparable);

- that tangible medium must be returned to its supplier at the end of its period of use, as opposed to simply becoming inoperable; and

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2. Paragraph 9 of the Commentary on Article 12 indicates that these words were deleted from the definition of royalties in order “to exclude income from … leasing [of such equipment] from the definition of royalties and, consequently, to remove it from the application of Article 12 in order to make sure that it would fall under the rules for the taxation of business profits…”
– the digital product must be used for business purposes, as opposed to personal purposes (e.g. such as enjoyment of music or of a computer game), so as to qualify as "industrial, commercial or scientific".

b) Computer equipment

35. The Group also examined a few transactions where it could be argued that tangible computer equipment (hardware) was being used by a customer so as to allow the relevant payment to be characterized as “payments for the use of, or the right to use, industrial, commercial or scientific equipment” (see categories 7 to 10 in section 3).

36. The Group examined various factors used to distinguish rental from service contracts for purposes of section 7701(e) of the U.S. Internal Revenue Code and found these factors to be useful for purposes of determining whether payments are for “the use of, or the right to use, industrial, commercial or scientific equipment”. Once adapted to the transactions examined by the Group, these factors can be formulated as follows:

(a) the customer is in physical possession of the property,
(b) the customer controls the property,
(c) the customer has a significant economic or possessory interest in the property,
(d) the provider does not bear any risk of substantially diminished receipts or substantially increased expenditures if there is nonperformance under the contract,
(e) the provider does not use the property concurrently to provide significant services to entities unrelated to the service recipient, and
(f) the total payment does not substantially exceed the rental value of the computer equipment for the contract period.

37. This is a non-exclusive list of factors, and some of these factors may not be relevant in particular cases. All relevant facts bearing on the substance of the transaction should be taken into account when determining whether the agreement is a service contract or a lease.

38. Applying these factors to application service provider transactions, the Group concluded that these should generally give rise to services income as opposed to rental payments. In a typical transaction, the service provider uses the software to provide services to customers, maintains the software as needed, owns the equipment on which the software is loaded, provides access to many customers to the same equipment, and has the right to update and replace the software at will. The customer may not have possession or control over the software or the equipment, will access the software concurrently with other customers, and may pay a fee based on the volume of transactions processed by the software.

39. Likewise, data warehousing transactions should be treated as services transactions. The vendor uses computer equipment to provide data warehousing services to customers, owns and maintains the equipment on which the data is stored, provides access to many customers to the same equipment, and has the right to remove and replace equipment at will. The customer will not have possession or control over the equipment and will utilize the equipment concurrently with other customers.
Provision of services

40. While the OECD Model Tax Convention does not distinguish between payments for the provision of services and payments for the sale or rental of property, which all fall within Article 7 (Business Profits), that distinction may be relevant for certain bilateral conventions as well as for some domestic tax law purposes. The Group therefore considered it useful to discuss the distinction between the provision of services and the transfer of property, noting that the preceding subsection already dealt with the particular question of the distinction between a rental of property and the provision of services.

41. The basic distinction between a transaction in goods versus a transaction in services is whether the customer acquires property from the provider. In this regard, for the majority of the members of the Group, the term “property” should be understood to include property which typically is carried on a tangible medium but may be transferred from medium to medium such as electronic data, a software program copy, digitised music or video images, and other forms of digital information and contents (see paragraph 44 for the position of the minority).

42. Generally speaking, if the customer owns the property after the transaction, but ownership of the property was not transferred from the vendor to the customer, then the transaction should be treated as a services transaction. For example, if the customer engages the vendor to create an item of property that the customer will own from the moment of its creation, then no property will have been transferred from the vendor to the customer, and the transaction should be characterized as the provision of services.

43. The Group recognized, however, that if the vendor transfers ownership of property to the customer, the transaction should nonetheless be characterized as a services transaction to the extent that the predominant nature of the transaction is the provision of services and the transfer of ownership is merely ancillary. This would be the case, for example, where the property itself has little intrinsic value and the vendor creates value through the exercise of its particular talents and skills to create a unique result for this customer. Online consulting or other professional services is an example of an electronic commerce transaction that typically results in services income. In these transactions, the customer usually does not receive any form of property. If the customer does receive property, such as a report, it most likely will have been created specifically for that customer and arguably was owned by the customer from the moment of its creation. If, however, the customer receives a valuable report or other property that was not created specifically for that customer, then the transaction could give rise to income from the sale of property. For example, the sale of the same investment report or other high-value proprietary information to many customers should be treated as a sale of property rather than a service. This should be the result even if the customer obtained the report electronically by downloading it from a database of reports maintained on the vendor’s server.

44. The members who adopt the minority view referred to in paragraph 24 above noted that they found it difficult to accept the preceding paragraphs 41 to 43 as drafted since these paragraphs refer to digital products as property and assume that there is a transfer of this property when the transaction takes place between the provider and the customer. In their view, the only property owned by the provider are rights in intellectual property (i.e. rights in the copyright) and the ownership of this intellectual property is not transferred to the customer when downloading a digital product. What is being transferred is the right to use such a property (i.e. rights in the copyright) that enables the customer to make a copy of the digital product. However, these members agreed that a distinction needed to be made between the provision of services on the one hand, and transactions which merely make existing digital information or products available to the customer. These members also agreed with the conclusion, in the above paragraph, that where the provider "creates value through the exercise of its particular talents and skills to create a unique result for the customer", this indicates that the transaction is for the provision of services. Even where the application of such talents and skills results in the creation of new digital products or other digitised information (such as a report or software) which is made available to the customer, this would generally be a merely ancillary part of the whole transaction which would not affect its characterization as income from
services. Where, however, existing digital information is made available to the customer (i.e. the digital product, etc is not created specifically for the customer), these members consider that, while the transaction should not be considered to be the provision of services, paragraph 24 above could apply to consider that the consideration for the payment is the use of a copyright if a copyright right is used by the customer to acquire the digital information.

Technical fees

45. The Group discussed how various e-commerce payments would be treated under alternative treaty provisions that allow source taxation of "technical fees".

46. While these provisions may be drafted differently, they often include the following definition:

"The term 'technical fees' as used in this Article means payments of any kind to any person, other than to an employee of the person making the payments, in consideration for any service of a technical, managerial or consultancy nature."

47. Given the limited number of bilateral conventions that include such provisions, there is relatively little guidance available as to their exact scope. The Group decided that it would therefore be useful to further research and discuss that issue. It especially invites comments from interested parties that may have practical experience with such provisions and, in particular, from countries that have included such provisions in their bilateral conventions.

Mixed payments

48. The Group identified a number of e-commerce transactions where the consideration of the payment could be considered to cover various elements (e.g. the software maintenance transactions described in category 12). It noted the principles for dealing with mixed contracts which are set out in paragraph 11 of the Commentary on Article 12.

49. It also noted, however, that the last sentence of the paragraph provides that "it seems possible to apply to the whole amount of the consideration the treatment applicable to the principal part" where "the other parts [...] are only of an ancillary and largely unimportant character". The Group considers that it would be more practical, as well as more consistent with the conclusions put forward in the recently approved changes to the Commentary on Article 12, to provide that, in such circumstances, the treatment applicable to the principal part should generally be applied to the whole consideration.

50. Some members of the Group also take the view that, in most e-commerce transactions, the treaty classification applicable to the predominant element of the payment involved should be applied to the whole of that payment. These members note that where as a commercial matter the transaction is regarded as a single transaction, an obligation to break-down the payments involved in these transactions, which often involve relatively small amounts of money (especially when private consumers are concerned), would impose an unreasonable compliance burden on taxpayers. The Group invites comments as to whether this is a significant practical issue.
SECTION 3. ANALYSIS OF VARIOUS CATEGORIES OF TYPICAL E-COMMERCE TRANSACTIONS

51. This section is an updated version of the draft released by the TAG on 24 March 2000. This new version reflects the fact that the principles underlying the conclusions reached by the Group are now presented in Section 2 of this note.

Category 1: Electronic order processing of tangible products

Definition

The customer selects an item from an online catalog of tangible goods and orders the item electronically directly from a commercial provider. There is no separate charge to the customer for using the online catalog. The product is physically delivered to the customer by a common carrier.

Analysis and conclusions

52. While the Group considers that category of transaction as a useful starting point, it does not see it as raising any treaty characterization issue. In this type of transaction, the payment made by the customer constitutes consideration that clearly falls within Article 7 (Business Profits) rather than Article 12 (Royalties), because it does not involve a use of copyright.

Category 2: Electronic ordering and downloading of digital products

Definition

The customer selects an item from an online catalog of software or other digital products and orders the product electronically directly from a commercial provider. There is no separate charge to the customer for using the online catalog. The digital product is downloaded onto the customer’s hard disk or other non-temporary media.

Analysis and conclusions

53. The Group found that this category of transaction raised the fundamental characterization issue discussed in paragraphs 20 to 24 above, i.e. the distinction between business profits and the part of the treaty definition of “royalties” dealing with payments for the use of, or the right to use, a copyright. It spent considerable time discussing that issue. While it was unanimously agreed that payments for software that would be so ordered and downloaded would fall within Article 7 as business profits, there were two opposing views as regards other digital products. The majority and minority views within the Group are presented in paragraphs 23 and 24 above. According to the majority, the payments made by the customer in this type of transaction would not constitute royalties but, rather, would fall within Article 7 as business profits. The minority view, however, is that, in this type of transaction, the payment made by the customer falls within the treaty definition of “royalties” if a copyright right is used by the customer to acquire the digital information.
Category 3: Electronic ordering and downloading of digital products for purposes of copyright exploitation

Definition

The customer selects an item from an online catalog of software or other digital products and orders the product electronically directly from a commercial provider. There is no separate charge to the customer for using the online catalog. The digital product is downloaded into the customer’s hard disk or other non-temporary media. The customer acquires the right to commercially exploit the copyright in the digital product (e.g. a book publisher acquires a copyrighted picture to be included on the cover of a book that it is producing).

Analysis and conclusions

54. The Group considered it useful to refer to this category of transaction in order to illustrate a case where all its members agree that the payment qualifies as a royalty. Indeed, in that case, the payment is made as consideration for the right to use the copyright in the digital product. In the example given, that use takes the form of the reproduction and sale, for commercial purpose, of the copyrighted picture.

Category 4: Updates and add-ons

Definition

The provider of software or other digital product agrees to provide the customer with updates and add-ons to the digital product. There is no agreement to produce updates or add-ons specifically for a given customer.

Analysis and conclusions

55. The Group agrees that this category of transaction should be treated

- like the transactions described in category 1 above if the updates and adds-on are delivered on a tangible medium;

- like the transactions described in category 2 above if the updates and adds-on are delivered electronically.

56. Thus, while the Group unanimously agrees that the payment made by the customer would fall under Article 7 if the updates and add-ons are delivered on a tangible medium, the minority view described in paragraph 24 does not agree with the majority that, in the case of digital products other than software, the result is the same if these are delivered electronically. It rather considers that the payment then constitutes a royalty if a copyright right is used by the customer to acquire the digital information.
Category 5: Limited duration software and other digital information licenses

Definition

The customer receives the right to use software or other digital products for a period of time that is less than the useful life of the product. The product is either downloaded electronically or delivered on a tangible medium such as a CD. All copies of the digital product are deleted or become unusable upon termination of the license.

Analysis and conclusions

57. Here again some members of the Group believe that a distinction needs to be made between situations where the product is provided on a tangible medium (e.g. CD) or downloaded electronically.

1) Product provided on a tangible medium

58. In that case, the Group unanimously concluded that, under the OECD Model as currently worded, the transaction should be treated exactly as transactions falling under category 1 so that the payment to the commercial provider of the limited duration digital product would fall under Article 7 (Business Profits).

59. Where, however, a particular convention includes a definition of royalties that covers “payments for the use of, or the right to use, industrial, commercial or scientific equipment”, the issue arises whether these words can be applied to a payment for a limited duration digital product provided on a tangible medium.

60. As explained in paragraphs 33 and 34 above, in the vast majority of cases, the Group unanimously agrees that such payments cannot be considered as payments "for the use of, or the right to use, industrial, commercial or scientific equipment". A minority within the Group, however, considers that, in some very limited cases, payments for the time-limited use of a digital product may be considered to be "for the use of, or the right to use, industrial, commercial or scientific equipment”. This would be the case only if all the following conditions were met:

- the digital product is provided on a tangible medium as opposed to being downloaded (those who adopt that view consider that the word equipment is broad enough to apply in that case as they consider that the equipment is the medium from which the digital content is inseparable);

- that tangible medium must be returned to its supplier at the end of its period of use, as opposed to simply becoming inoperable; and

- the digital product must be used for business purposes, as opposed to personal purposes (e.g. such as enjoyment of music or of a computer game), so as to qualify as "industrial, commercial or scientific".
2) **Downloaded products**

61. The differences of views expressed in the case of digital products, other than software, that are downloaded electronically (see paragraphs 33 and 34 above) are also relevant in cases where those products have a limited duration. Under the current wording of the OECD Model, a majority of the Group takes the view that payments for the latter would fall under Article 7 (Business Profits) while a minority argues that they would be covered by Article 12 (Royalties) if a copyright right is used by the customer to acquire the digital information.

62. As regards digital products that are downloaded, as opposed to being provided on a tangible medium, it follows from paragraph 60 above that the Group unanimously agrees that such payments cannot be considered as payments “for the use of, or the right to use, industrial, commercial or scientific equipment” for purposes of bilateral conventions where the definition of royalties covers such payments.

**Category 6: Single-use software or other digital product**

**Definition**

*The customer receives the right to use software or other digital products one time. The product may be either downloaded or used remotely (e.g. use of software stored on a remote server). The customer does not receive the right to make copies of the digital product other than as required to use the digital product for its intended use.*

**Analysis and conclusions**

63. Some members view this type of transaction as contracts for services. They distinguish these transactions from those described in categories 2 and 5 above based on the fact that property is not transferred for a sufficiently long period to constitute either a sale or lease.

64. Other members disagree and would treat these transactions similarly to those referred to in categories 2 and 5. For those members who adopt the minority position described in category 2, it would then be important, in the case of digital products other than software, to distinguish between cases where the product is downloaded onto the customer's hard disk or other non-temporary media from those where it is not (e.g. where it is used remotely or copied into RAM only) as only the former case would give rise to a royalty characterization.

**Category 7: Application Hosting - Separate License**

**Definition**

*A user has a perpetual license to use a software product. The user enters into a contract with a host entity whereby the host entity loads the software copy on servers owned and operated by the host. The host provides technical support to protect against failures of the system. The user can access, execute and operate the software application remotely. The application is executed either at a customer's computer after it is downloaded into RAM or remotely on the host's server. This type of arrangement could apply, for example, for financial management, inventory control, human resource management or other enterprise resource management software applications.*
Analysis and conclusions

65. The Group agrees that, under the current wording of the OECD Model, this type of transaction gives rise to business profits falling under Article 7.

66. Where, however, a particular convention includes a definition of royalties that covers “payments for the use of, or the right to use, industrial, commercial or scientific equipment”, the issue arises whether these words can be applied to all or part of the payments arising from these transactions.

67. As discussed in paragraphs 35 to 39 above, the Group concluded that these transactions should generally give rise to services income as opposed to rental payments. In a typical transaction, the vendor uses computer equipment to provide data warehousing services to customers, owns and maintains the equipment on which the data is stored, provides access to many customers to the same equipment, and has the right to remove and replace equipment at will. The customer will not have possession or control over the equipment and will utilize the equipment concurrently with other customers.

68. The Group also discussed whether payments arising in this type of transaction could be treated as payments for services of a “technical nature” under alternative treaty provisions that allow source taxation of "technical fees". The majority believes that this is possible, especially where the host provides back-up and secure access services. Some members disagree on the basis that the mere hosting of an application would not involve the provision of technical services but, rather, services more akin to warehousing. As noted in paragraph 47 above, the Group concluded that it would be useful to further research and discuss that issue.

Category 8: Application Hosting - Bundled Contract

Definition

For a single, bundled fee, the user enters into a contract whereby the provider, who is also the copyright owner, allows access to one or more software applications, hosts the software applications on a server owned and operated by the host, and provides technical support for the hardware and software. The user can access, execute and operate the software application remotely. The application is executed either at a customer's computer after it is downloaded into RAM or remotely on the host's server. The contract is renewable annually for an additional fee.

Analysis and conclusions

69. The Group agrees that, under the current wording of the OECD Model, there would be no need to separate the payment described in this example as all of it would constitute business profits falling under Article 7.

70. The need to separate the payment into various components could arise, however, when applying bilateral conventions that include the alternative provisions referred to in the previous category. As discussed in that category, delegates had different views as to whether these provisions could apply. It was noted, however, that if the host provided the use of financial management software, it would seem likely that the part of the payment attributable to the use of that software could constitute payments for services of a “managerial” nature, so as to fall under the previously quoted definition of technical fees.
Category 9: Application Service Provider ("ASP")

Definition

The provider obtains a license to use a software application in the provider's business of being an application service provider. The provider makes available to the customer access to a software application hosted on computer servers owned and operated by the provider. The software automates a particular back-office business function for the customer. For example, the software might automate sourcing, ordering, payment, and delivery of goods or services used in the customer's business, such as office supplies or travel arrangements. The provider does not provide the goods or services. It merely provides the customer with the means to automate and manage its interaction with third-party providers of these goods and services. The customer has no right to copy the software or to use the software other than on the provider’s server, and does not have possession or control of a software copy.

Analysis and conclusions

71. As regards the payment made by the customer, the Group agrees that the issues arising are similar to those discussed under the preceding category.

Category 10: ASP License Fees

Definition

In the example above, the ASP pays the provider of the software application a fee which is a percentage of the revenue collected from customers. The contract is for a one year term.

Analysis and conclusions

72. The Group agrees that this type of transaction, being essentially for the provision of a software product to be used in the business of the transferee, falls within Article 7. The Group acknowledged that the fact that the ASP's customer will have access to the software copy hosted on servers owned and operated by the provider may technically involve the ASP displaying to the customers some copyrighted information (e.g. forms for data input). The Group agreed, however, that if providing such access constituted the use of a copyright right by the ASP (for example a display or other right), such use of copyright would be such a minimal part of the consideration for the payment made by the ASP to the software provider that it should not be relevant for the treaty characterization of that payment.

Category 11: Web site hosting

Definition

The provider offers space on its server to host web sites. The provider obtains no rights in the copyrights created by the developer of the web site content. The owner of the copyrighted
material on the site may remotely manipulate the site, including modifying the content on the site. The provider is compensated by a fee based on the passage of time.

**Analysis and conclusions**

73. The Group agrees that, under the current wording of the OECD Model, this type of transaction gives rise to business profits falling under Article 7. The Group also notes that where a particular convention includes a definition of royalties that covers “payments for the use of, or the right to use, industrial, commercial or scientific equipment” or alternative treaty provisions that allow source taxation of "technical fees", this type of transaction would give rise to the issues that are discussed under category 7, which deals with application hosting.

**Category 12: Software maintenance**

**Definition**

Software maintenance contracts typically bundle software updates together with technical support. A single annual fee is charged for both updates and technical support. In most cases, the principal object of the contract is the software updates.

**Analysis and conclusions**

74. The Group concluded that the remarks expressed in paragraphs 48 to 50 above as regards mixed contracts, which refer to the principles set out in paragraph 11 of the Commentary on Article 12, apply to such transactions. Where, under those principles, part of the payment is regarded to be for the provision of technical support, the issues described in category 14 below as regards alternative treaty provisions that allow source taxation of "technical fees" will arise.

**Category 13: Data warehousing**

**Definition**

The customer stores its computer data on computer servers owned and operated by the provider. The customer can access, upload, retrieve and manipulate data remotely. No software is licensed to the customer under this transaction. An example would be a retailer who stores its inventory records on the provider's hardware and persons on the customer's order desk remotely access this information to allow them to determine whether orders could be filled from current stock.

**Analysis and conclusions**

75. The Group agrees that, under the current wording of the OECD Model, this type of transaction gives rise to business profits falling under Article 7. The Group also notes that where a particular convention includes a definition of royalties that covers “payments for the use of, or the right to use, industrial, commercial or scientific equipment” or alternative treaty provisions that allow source taxation
of "technical fees", this type of transaction would give rise to the issues that are discussed under category 7, which deals with application hosting.

**Category 14: Customer support over a computer network**

**Definition**

The provider provides the customer with online technical support, including installation advice and trouble-shooting information. This support can take the form of online technical documentation, a trouble-shooting database, and communications (e.g. by e-mail) with human technicians.

**Analysis and conclusions**

76. The Group agreed that, based on this description and under the wording of the OECD Model Convention, the payment arising in this type of transaction would fall within Article 7. Some members who shared the minority view described in paragraph 34 argued, however, that this would only be the case as long as the electronic downloading and copying of technical documentation remained an incidental part of the consideration for the payment. While they did not consider that downloading documentation solely for viewing purposes would constitute the use of a copyright for purposes of the definition of royalties, they expressed the view that if a substantial part of the payment related to the downloading of documentation onto the customer’s hard disk or other non-temporary medium in order to make that documentation available to the user, the characterization issue arising from the transactions described in category 2 above would arise.

77. In reaching its conclusion, the Group discussed the extent to which the payment could be considered as a payment for "information concerning industrial, commercial or scientific experience" (know-how) so as to constitute royalties.

78. Based on paragraphs 22 to 27 above and, in particular, the factors listed in paragraph 26, the Group agrees that online advice, communications with technicians and using the trouble-shooting database, would clearly involve actual services being performed on demand rather than the provision of know-how.

79. While the provision of technical documentation could, depending on the circumstances, constitute the provision of know-how, this would require that the information be "undivulged technical information" as described in paragraph 11 of the Commentary on Article 12. Also, as mentioned in the same paragraph, know-how "is necessary for the industrial reproduction of a product or process". To the extent that know-how must be technical information relating to industrial reproduction of a product or process, the Group considers that information that merely relates to the operation or use of products as opposed to their development or production would not fall under the definition of know-how.

80. The Group notes that the remarks in paragraphs 48 to 50 above, which deals with mixed contracts, would be relevant if the contract were considered to cover the provision of both services and know-how.

81. The Group finally discussed how the payment arising in this type of transaction would be treated under alternative treaty provisions that allow source taxation of "technical fees".
82. Given the wide scope of this definition, it was suggested that it would be difficult to see how services provided under the type of transaction described above would not constitute services "of a technical nature". As noted in paragraph 47 above, however, the Group concluded that it would be useful to further research and discuss that issue.

Category 15: Data retrieval

Definition

The provider makes a repository of information available for customers to search and retrieve. The principal value to customers is the ability to search and extract a specific item of data from amongst a vast collection of widely available data.

Analysis and conclusions

83. Most members of the Group consider that the payment arising from this type of transaction would fall under Article 7. Some of them reach that conclusion because, given that the principal value of such a database would be the ability to search and extract the documents, these members view the contract as a contract for services. Others consider that, in this transaction, the customer pays in order to ultimately obtain the data that he will search for. They therefore view the transaction as being similar to those described in category 2 and will accordingly treat the payment as business profits as they adopt the majority view described in that section. A few members, however, also view the transaction as being similar to those described in category 2 but, since they prefer the minority view described in that section, they would treat the payment as royalties.

84. As many members consider that these transactions involve essentially the provision of services, the Group also addressed the issue of whether these could be considered as services “of a technical nature” under the alternative provisions on technical fees previously referred to. While a few members argued that searching and retrieval services were not, in themselves, of a technical nature even though the process through which these services were provided involved substantial technology in the transactions under consideration, it was decided, as noted above, that the issue should be further researched and discussed.

Category 16: Delivery of exclusive or other high-value data

Definition

As in the previous example, the provider makes a repository of information available to customers. In this case, however, the data is of greater value to the customer than the means of finding and retrieving it. The provider adds significant value in terms of content (e.g. by adding analysis of raw data) but the resulting product is not prepared for a specific customer and no obligation to keep its contents confidential is imposed on customers. Examples of such products might include special industry or investment reports. Such reports are either sent electronically to subscribers or are made available for purchase and download from an online catalog or index.
Analysis and conclusions

85. The Group agrees that these transactions involve the same characterization issues as those described in the previous category. The majority therefore believes that the payment arising from this type of transaction would fall under Article 7. However, some members who share the minority view described in paragraph 34 would distinguish the two types of transactions on the basis that, here, the primary consideration for the payment is no longer for the provision of search and extract services but, rather, for the right to reproduce valuable data. These members would therefore consider that, unlike the transactions covered by the previous category, this type of transactions gives rise to royalties.

Category 17: Advertising

Definition

Advertisers pay to have their advertisements disseminated to users of a given web site. So-called “banner ads” are small graphic images embedded in a web page, which when clicked by the user will load the web page specified by the advertiser. Advertising rates are most commonly specified in terms of a cost per thousand “impressions” (number of times the ad is displayed to a user), though rates might also be based on the number of “click-throughs” (number of times the ad is clicked by a user).

Analysis and conclusions

86. All members of the Group agreed that the payments arising from these transactions would constitute business profits falling under Article 7 rather than royalties, even under alternative definitions of royalties that cover payments “for the use, or the right to use, industrial, commercial or scientific equipment”.

Category 18: Electronic access to professional advice (e.g. consultancy)

Definition

A consultant, lawyer, doctor or other professional service provider advises customers through email, video conferencing, or other remote means of communication.

Analysis and conclusions

87. Again, all members of the Group agreed that the payments arising from these transactions would constitute business profits falling under Article 7 rather than royalties. As already stated, the provision of on-demand advice is a service and not the supply of know-how.

88. As these transactions involve the provision of services, the Group also addressed the issue of whether these could be considered as services “of a technical nature” under the alternative provisions on technical fees that have been previously referred to. While it wants to further research and discuss the issue, the Group reached the preliminary view that the services involved are of a “technical […] or consultancy nature” so as to fall under the definition of “technical fees” that is most often used.
Category 19:  Technical information

Definition

The customer is provided with undivulged technical information concerning a product or process (e.g. narrative description and diagrams of a secret manufacturing process).

Analysis and conclusions

89. The Group agrees that payments arising from this category of transactions constitute royalties as they are made for the supply of know-how, i.e. “for information concerning industrial, commercial or scientific experience.”

Category 20:  Information delivery

Definition

The provider electronically delivers data to subscribers periodically in accordance with their personal preferences. The principal value to customers is the convenience of receiving widely available information in a custom-packaged format tailored to their specific needs.

Analysis and conclusions

90. The Group agrees that this type of transaction raises basically the same issues as those described under category 15 above. Most members of the Group therefore consider that the payments arising from these transactions constitute business profits falling under Article 7 but some members who adopt the minority view described in paragraph 34 would treat these payments as royalties.

Category 21:  Subscription-based interactive web site access

Definition

The provider makes available to subscribers a web site featuring digital content, including information, music, video, games, and activities (whether or not developed or owned by the provider). Subscribers pay a fixed periodic fee for access to the site. The principal value of the site to subscribers is interacting with the site while online as opposed to getting a product or services from the site.

Analysis and conclusions

91. The Group agrees that the subscription fee paid in this type of transactions would constitute a payment for services. As that payment is mainly for the interaction with the site for purposes of the personal enjoyment of the user and not for the provision of any service of a technical, managerial or consultancy nature, it would not, under the previously quoted definition of “technical fees”, fall under the
alternative provisions covering these types of payments. The Group also agreed any payment to the owner of the copyright in the digital content that would be made by the provider for the right to display that content to its subscribers would constitute royalties.

**Category 22: Online shopping portals**

**Definition**

A web site operator hosts electronic catalogs of multiple merchants on its computer servers. Users of the web site can select products from these catalogs and place orders online. The web site operator has no contractual relationship with shoppers. It merely transmits orders to the merchants, who are responsible for accepting and fulfilling orders. The merchants pay the web site operator a commission equal to a percentage of the orders placed through the site.

**Analysis and conclusions**

92. The Group agrees that these payments are revenues from advertising or similar services that constitute business profits falling under Article 7.

**Category 23: Online auctions**

**Definition**

The provider displays many items for purchase by auction. The user purchases the items directly from the owner of the items, rather than from the enterprise operating the site. The vendor compensates the provider with a percentage of the sales price or a flat fee.

**Analysis and conclusions**

93. The Group agrees that these payments are revenues similar to those of an auction house and constitute business profits falling under Article 7.

**Category 24: Sales referral programs**

**Definition**

An online provider pays a sales commission to the operator of a web site that refers sales leads to the provider. The web site operator will list one or more of the provider’s products on the operator’s web site. If a user clicks on one of these products, the user will retrieve a web page from the provider’s site from which the product can be purchased. When the link on the operator’s web page is used, the provider can identify the source of the sales lead and will pay the operator a percentage commission if the user buys the product.
Analysis and conclusions

94. The Group agrees that these payments constitute business profits falling under Article 7.

Category 25: Content acquisition transactions

Definition

A web site operator pays various content providers for news stories, information, and other online content in order to attract users to the site. Alternatively, the web site operator might hire a content provider to create new content specifically for the web site.

Analysis and conclusions

95. The Group agrees that the two alternatives described above need to be distinguished. Where the site operator pays a content provider for the right to display copyrighted material, the payment would fall under the definition of royalties to the extent that the public display of the content constitutes a right covered by the copyright of the owner of the content. Where, however, the operator pays for the creation of new content and, as a result of the relevant contractual arrangements, becomes the owner of the copyright in the content so created, the payment cannot be for royalties and falls under Article 7.

Category 26: Streamed (real time) web based broadcasting

Definition

The user accesses a content database of copyrighted audio and/or visual material. The broadcaster receives subscription or advertising revenues.

Analysis and conclusions

96. The Group agrees that the subscription or advertising fees that would be received in these transactions would constitute business profits falling under Article 7. Members who adopt the minority view described in paragraph 34 noted that, in this example, they assume that the subscription allows only the real time enjoyment of web-broadcasted material and not the downloading of copyrighted material onto the customer’s hard disk or other non-temporary media. Therefore, the royalty issues described in category 2 do not arise.

Category 27: Carriage fees

Definition

A content provider pays a particular web site or network operator in order to have its content displayed by the web site or network operator.
Analysis and conclusions

97. The Group agrees that in that type of transactions, the web site or network operator is providing a commercial service for a fee and its income should be characterized as business profits under Article 7. In these transactions, unlike in those described in category 25, it is the owner of the copyrighted material who makes the payment, which makes it clear that Article 12 is not applicable.