OECD Progresses towards Achieving an International Consensus on the Tax Treatment of E-commerce

Representatives of OECD governments have agreed on a number of important conclusions and recommendations that pave the way for greater certainty among businesses and consumers in relation to the taxation of electronic commerce. These conclusions and recommendations by the OECD’s Committee on Fiscal Affairs, and the business/government advisory groups that it has set up, cover three main areas: international direct taxation; consumption taxes; and tax administration.

Gabriel Makhlouf, the Committee’s Chair, greeted the conclusions and recommendations as “a significant step forward” in international efforts co-ordinated by the OECD to address the tax implications of e-commerce. On income taxes, OECD countries have now reached a broad consensus on the interpretation of existing permanent establishment rules that are fundamental for deciding where profits on the conduct of e-commerce can be taxed. They are now working on clarifying the tax treaty treatment of various types of e-commerce payments on the basis of a report just received from a business/government advisory group set up to examine this issue.

In the area of consumption taxes, OECD countries have made significant progress towards identifying pragmatic ways of achieving the desired result of effective taxation in the place of consumption. In the area of tax administration, OECD governments have reached agreement on the main administrative challenges and opportunities facing tax administrations, and on the sort of responses that governments need to consider. They are now inviting public comments on their proposals, in respect of consumption taxes and tax administration.

“There is much that tax administrations can and should do to share their experience and expertise internationally, especially in the field of taxpayer service,” Mr. Makhlouf said. “It is important that we maintain our efforts to strengthen the emerging international consensus, so as to provide governments and business with the certainty that they need about how taxation rules should apply to e-commerce.”

The Committee’s work on e-commerce draws its impetus from the Ottawa Taxation Framework Conditions, a set of principles about how governments should respond to the tax implications of e-commerce, welcomed by OECD Member and non-member governments at an international Ministerial Conference on e-commerce held in Ottawa in October 1998. These principles have since been widely recognised as representing a strong foundation for the Committee’s current more detailed work. At a recent meeting in Paris, the Committee restated its commitment to a continuing dialogue with the international business community and non-OECD member economies on these issues, and approved new arrangements for taking forward this dialogue.

Details of the Committee’s conclusions and recommendations can be found in the attached annexes to this release and on the OECD’s website at http://www.oecd.org/dae/fa. For further information, journalists are invited to contact Meggan Dissly in the OECD’s Media Relations Division (tel. 33 1 45 24 80 94 or meggan.dissly@oecd.org).

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Annex 1:
Emerging conclusions and recommendations from the OECD’s Committee on Fiscal Affairs and publication of reports

i) International direct tax issues

The Committee welcomed the broad consensus recently achieved on clarification in the Commentary on the OECD Model Tax Convention (‘Model’) in respect of the application of the current definition of permanent establishment (PE). In short, the clarification states that a web site cannot, in itself, constitute a PE; that a web site hosting arrangement typically does not result in a PE for the enterprise that carries on business through that web site; that an Internet service provider normally will not constitute a dependent agent of another enterprise so as to constitute a PE for that enterprise and that while a place where computer equipment, such as a server, is located may in certain circumstances constitute a permanent establishment, this requires that the functions performed at that place be significant as well as an essential or core part of the business activity of the enterprise.

The Committee also welcomed the report of its Technical Advisory Group on Treaty Characterisation of E-commerce Payments (see Annex 2 below), and agreed that this report would help the Committee to reach an early agreement on how treaty characterisation issues should be resolved and how the Commentary on the Model should be clarified in that respect. This clarification will address how payments for e-commerce transactions should be characterised for tax treaty purposes.

ii) Consumption tax issues

The Committee endorsed the emerging conclusions in a report from its Working Party on Consumption Taxes, and approved its release for public comment. The report notes that it is necessary to define the principle of taxation in the place of consumption more clearly; and to identify the collection mechanisms that can best support the practical operation of that principle.

The report proposes Guidelines to define the place of taxation for cross-border services and intangible property by reference to the business establishment of the recipient business in the case of for B2B (business-to-business) transactions, and by reference to the recipient’s usual jurisdiction of residence for B2C (business-to-consumer) transactions. On collection mechanisms, the report identifies a self-assessment mechanism for B2B transactions as the most viable option. For B2C transactions, the report points toward the potential in the medium term for technology-facilitated options, while accepting that, in the interim, simplified registration-based mechanisms may be required. The report recognises that further work is necessary in several areas, and recommends that this continue to be pursued in partnership with business.

iii) Tax administration issues

The Committee likewise endorsed the emerging conclusions and future work topics identified in a report on the tax administration aspects of e-commerce, and approved its publication for comment. This report addresses such issues as how tax administrations can ensure effective tax collection in an electronic environment, and the steps that they may need to take to strengthen their co-operation internationally. It also identifies a range of initiatives that tax administrations across the world are already taking to improve the quality of service that they provide to taxpayers.

iv) Further work and future process

The Committee recognises that much further work remains to be done in several fields. The release of discussion papers is an important part of that process. Principal features of its work programme for 2001-2003 include:

- On direct taxes: work on issues associated with the attribution of profits to a server PE; on the refinement of the ‘place of effective management’ concept in determining residence for taxation
purposes; and further evaluation of the adequacy of the current treaty rules in the context of electronic commerce, taking into account possible alternatives and the possible clarification or modification of the existing rules.

- On consumption taxes: work on the feasibility of technology-based collection mechanisms, on simplification opportunities, and on means of promoting more effective international administrative co-operation.

- On tax administration issues: work to strengthen the compliance tools available to tax administrations, to share “best practice” and to promote further taxpayer service initiatives.

On process, the Committee agreed on the need to continue the dialogue with business and non-members, through a reinforcement of the current Technical Advisory Group (TAG) process and other initiatives to encourage further co-operative international debate.

v) **Publication of reports and technical papers**

The Committee will shortly be publishing a comprehensive progress report covering all aspects of its work on the taxation aspects of e-commerce. In the interim the following reports and technical papers are available at [http://www.oecd.org/daf/fa](http://www.oecd.org/daf/fa) for information and/or comment (as indicated below):

**On international direct tax issues**

*For information:* The full text of the agreed clarification to the commentary on the Model Tax Convention on the interpretation of the existing definition of permanent establishment

*For information:* The report by the Treaty Characterisation TAG, which the Committee will be using as the basis for its work on how treaty characterisation issues should be resolved (see annex 2)

*For public comment:* Discussion papers on the attribution of profit to a server PE, and on the place of effective management

*For information:* A report by the Business Profits TAG

**On consumption tax issues**

*For public comment:* A report by the Committee’s Working Party on Consumption Taxes

*For information:* A report by the Consumption Tax TAG

*For information:* A report from the Technology TAG

**On tax administration issues**

*For public comment:* A report by the Committee’s Forum on Strategic Management

*For information and public comment:* A report by the Professional Data Assessment TAG
Annex 2:

Report by the Technical Advisory Group on Treaty Characterisation

The Technical Advisory Group (TAG) on Treaty Characterisation, which was set up in the context of the OECD work on taxation and e-commerce, released on 1st February its final report on how various types of payments for e-commerce transactions should be characterised for purposes of applying tax treaties. The report is available on the OECD’s website at: http://www.oecd.org/daf/fa/treaties/treatychar_finalrep.pdf

The report, which was unanimously approved by TAG members, deals with the interpretation of tax treaties for the purpose of determining which provisions apply to various types of e-commerce payments, thereby ultimately determining which country may tax these payments and under what conditions. It includes analysis, conclusions and recommendations concerning which treaty provisions apply in particular cases, as well as the TAG’s views on how such recommendations would apply in 28 typical categories of e-commerce transactions. Some of the TAG’s principal conclusions and recommendations are:

- in the case of transactions that permit the customer to electronically download digital products for that customer’s own use or enjoyment (for instance, where a customer orders software or music from an Internet web site and that digital product is downloaded from that site), the payment should be characterised as business profits rather than as a royalty;

- whilst e-commerce transactions resulting in know-how payments which constitute royalties are relatively rare, the report provides a number of criteria and examples to help distinguish the provision of services from the provision of know-how;

- payments for time-limited use of digital products or for transactions such as data warehousing cannot be considered as payments for the use of, or the right to use, an industrial, commercial or scientific equipment so as to constitute royalties under some conventions;

- where the consideration for the payment cover various elements but one element is predominant and the others are only of an ancillary and unimportant character, it would be more practical to apply the treatment applicable to the principal part to the whole consideration.

The recommendations of the report, and in particular the suggestions for changes to the Commentaries of the OECD Model Tax Convention that it includes, will now be examined by the Committee on Fiscal Affairs with a view to quickly make the appropriate changes to the OECD Model Tax Convention. (The OECD Model Tax Convention, first published in 1963 and regularly updated since then, is the basic reference manual used by both OECD and non-OECD countries for the negotiation, application and interpretation of bilateral tax treaties co-ordinating their direct tax systems).

The TAG was set up in 1999 by the OECD’s Committee on Fiscal Affairs with the mandate “to examine the characterisation of various types of electronic commerce payments under tax conventions with a view to providing the necessary clarifications.” Members of the TAG included tax officials from OECD and non-OECD countries as well as representatives from the business community. The TAG was co-chaired by: Ariane Pickering (Australian Tax Office), Gary D. Sprague (Baker & McKenzie) and Liselott Kana (Ministry of Finance of Chile).

The report follows two previous drafts released by the TAG for public comment in March and September 2000. While these drafts reflected some substantial disagreements among the members of the TAG, the comments received helped the TAG to resolve these disagreements at its last meeting, which was held in Mumbai (India) on 6-7 November 2000. This led the way to the adoption of this unanimous report.