

# Treaty characterisation issues arising from e-commerce

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## 1. Introduction

1. In January 1999, as a follow-up to the November 1998 Ottawa conference entitled “A Borderless World - Realising the Potential of Electronic Commerce”, the Committee on Fiscal Affairs set up a Technical Advisory Group (TAG) on Treaty Characterisation Issues arising from E-Commerce with the general mandate “to examine the characterisation of various types of electronic commerce payments under tax conventions with a view to providing the necessary clarifications in the Commentary.” That Group was composed of business representatives and tax officials from OECD and non-OECD countries.

2. The final report of the TAG was released on 1 February 2001.<sup>1</sup> The report described the various treaty characterisation issues that were identified by the Group and presented the views of the Group concerning these issues; it also included an analysis of various categories of typical e-commerce transactions. The report included the recommendation that the OECD Working Party No. 1 on Tax Conventions and Related Questions “... issue a document clarifying, along the lines of section 3 of this report, how the various tax treaty characterisation issues arising from e-commerce should be solved...” and invited the Working Party “...to take account of the suggestions for changes to the Commentary of the OECD Model Tax Convention which are included in this report.”

3. The Committee on Fiscal Affairs, through its Working Party No. 1, subsequently examined the TAG report in detail. It found the conclusions and suggestions of the TAG highly persuasive. It therefore decided to follow the TAG recommendation and adopted<sup>2</sup> the present report, which largely reproduces the TAG report and generally adopts the TAG’s suggestions for changes to the Commentary on Article 12.

4. The Committee expresses its thanks to the members of the TAG for their valuable work and their contribution to clarifying how existing tax treaties apply in the context of e-commerce.

<sup>1</sup> The TAG report is available at <http://www.oecd.org/pdf/M000015000/M00015536.pdf> and in the publication entitled *Taxation and Electronic Commerce – Implementing the Ottawa Taxation Framework Conditions*, OECD, Paris 2001, page 85.

<sup>2</sup> See, however, the observations by Greece and Spain included in Annex 3.

## 2. Overview of the report

5. This report is divided as follows:
- sections 1 to 4 include a description of the various treaty characterisation issues that may arise in electronic commerce together with the conclusions of the Committee on how to address these issues;
  - annex 1 reproduces all the changes to the Commentaries on the Model Tax Convention that are put forward in this report;
  - annex 2 includes an illustrative list of typical e-commerce transactions with the conclusions of the Committee as to how payments arising from these transactions should be characterised for tax treaty purposes (this list is similar to the one included in annex 2 of the TAG report).
6. Throughout this report, it is generally assumed that the payments that are referred to are received in the course of carrying on a business, whether or not the payers are 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. For these reasons, the payments referred to in this report should not be considered to fall within Article 21, which deals with other income.

## 3. Business profits and royalties

7. 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.”

8. In the OECD 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.
9. This section analyses classification issues arising from the possible application of various elements of these two definitions to payments made in e-commerce transactions. It also examines classification issues arising from alternative treaty provisions which deal with the provision of services or technical fees.

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

#### *Analysis and conclusions*

10. One of the most important characterisation issues arising from e-commerce is 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. The conclusions below on how that issue should be addressed are fully consistent with the position already expressed in paragraphs 14 to 14.2 of the Commentary on Article 12 as regards software payments.
11. Since the definition of royalties applies to “payments for” any of the various items listed in that definition, the main question to be addressed in any given transaction is the identification of that for which the payment is made. 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 by the customer, e.g. because a right to make one or more copies of the digital content is granted under the contract. Where the essential consideration is for something other than the use of, or right to use, rights in the copyright (such as to acquire other types of contractual rights, 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, network or other storage, performance or display device, such use of copyright should not affect the analysis of the character of the payment for treaty purposes. 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. Whilst

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, that possible use of a copyright is not that for which the payment is essentially made.

12. In the case of transactions that permit the customer to electronically download digital products (such as software, images, sounds or text), the payment is made to acquire data transmitted in the form of a digital signal for the own use or enjoyment of the acquirer.<sup>3</sup> This constitutes that for which the payment is essentially made. To the extent that the act of copying the digital signal onto the customer's hard disk or other non-temporary media (including transfers to other storage, performance or display devices) constitutes the use of a copyright by the customer under the relevant law and contractual arrangements, this is merely an incidental part of the process of capturing and storing the digital signal. This incidental part is not important for classification purposes because it does not correspond to the essential consideration for the payment (i.e. to acquire data transmitted in the form of a digital signal), which is the determining factor for the purposes of the treaty definition of royalties.

### *Changes to the Commentary*

13. Based on that analysis, the Committee concluded that the following changes should be made to the Commentary on Article 12 of the OECD Model Tax Convention:

*Add the following paragraphs 17.1 to 17.4 immediately after paragraph 17 of the Commentary on Article 12:*

"17.1 The principles expressed above as regards software payments are also applicable as regards transactions concerning other types of digital products such as images, sounds or text. The development of electronic commerce has multiplied the number of such transactions. In deciding whether or not payments arising in these transactions constitute royalties, the main question to be addressed is the identification of that for which the payment is essentially made.

17.2 Under the relevant legislation of some countries, transactions which permit the customer to electronically download digital products may give rise to use of copyright by the customer, e.g. because a right to make one or more copies of the digital content is granted under the contract. Where the consideration is essentially for something other than for the use of, or right to use, rights in the copyright (such as to acquire other types of contractual rights, 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, network or other storage, performance or display device, such use of copyright should not affect the analysis of the character of the payment for purposes of applying the definition of "royalties".

17.3 This is the case for transactions that permit the customer (which may be an enterprise) to electronically download digital products (such as software, images, sounds or text) for that customer's own use or enjoyment. In these transactions, the payment is essentially for the acquisition of data transmitted in the form of a digital signal and therefore does not constitute royalties but falls within Article 7 or Article 13, as the case may be. To the extent that the act of copying the digital signal onto the customer's hard disk or other non-temporary media involves the use of a copyright by the customer under the relevant law and contractual arrangements, such copying is merely the means by which the digital signal is captured and stored. This use of copyright is not important for classification purposes because it does not correspond to what the payment is essentially in consideration for (i.e. to acquire data transmitted in the form of a digital signal), which is the determining factor for the purposes of the definition of royalties. There also would be no basis to classify such transactions as "royalties" if, under the relevant law and contractual arrangements, the creation of a copy is regarded as a use of copyright by the provider rather than by the customer.

17.4 By contrast, transactions where the essential consideration for the payment is the granting of the right to use a copyright in a digital product that is electronically downloaded for that purpose will give rise to royalties. This would be the case, for example, of a book publisher who would pay to acquire the right to reproduce a copyrighted picture that it would electronically download for the purposes of including it on the cover of a book that it is producing. In this transaction, the essential consideration for the payment is the acquisition of rights to use the copy-

<sup>3</sup> The same result would apply regardless of whether the payment was made as regards the downloading of one specific product or in the form of a subscription fee for the right to access a web site where that digital product may be downloaded.

right in the digital product, i.e. the right to reproduce and distribute the picture, and not merely for the acquisition of the digital content.”

### 3.b. Business profits and payments for know-how

#### Analysis and conclusions

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

15. 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 ANBPPI [*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”.

16. 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.

17. Applying these criteria and examples to e-commerce transactions, the Committee concluded 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.

18. The distinction between payments for services rendered and payments for the supply of know-how may sometimes raise practical difficulties. Countries have used various criteria to solve these difficulties and the following are examples of criteria developed for that purpose:

- Typically, 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, typically:
  - 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 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.

19. As regards the particular case of a contract involving the provision, by the supplier, of information concerning computer programming, the Committee concluded that, as a general rule, the payment will only be considered to be made in consideration for the provision of such information so as to constitute know-how where it is made to acquire information constituting ideas and principles underlying the program, such as logic, algorithms or programming languages or techniques, where this information is provided under the condition that the customer not disclose it without authorisation and where it is subject to any available trade secret protection.

#### *Changes to the Commentary*

20. The Committee considered that it would be useful to provide greater guidance in the Commentary, on the basis of the above criteria and factors, on the distinction to be made between payments for the provision of know-how and payments for the provisions of services. It therefore concluded that the following changes should be made to the Commentary on Article 12 of the OECD Model Tax Convention:

*Replace paragraph 11 of the Commentary on Article 12 by the following paragraphs 11 to 11.5 (additions to the existing text of paragraph 11 appear in **bold italics**):*

"11. In classifying as royalties payments received as consideration for information concerning industrial, commercial or scientific experience, paragraph 2 alludes to the concept of "know-how". Various specialist bodies and authors have formulated definitions of know-how which do not differ intrinsically. One such definition, given by the "Association des Bureaux pour la Protection de la Propriété Industrielle" (ANBPPI), states that 'know-how is all the undivulged technical information, whether capable of being patented or not, 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'.

**11.1** 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. It is recognised that the grantor is not required to play any part himself in the application of the formulas granted to the licensee and that he does not guarantee the result thereof.

**11.2** This type of contract thus differs from contracts for 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. ***Payments made under the latter contracts generally fall under Article 7.***

**11.3** ***The need to distinguish these two types of payments, i.e. payments for the supply of know-how and payments for the provision of services, sometimes gives rise to practical difficulties. The following criteria are relevant for the purpose of making that distinction:***

- ***Contracts for the supply of know-how concern information of the kind described in paragraph 11 that already exists or concern the supply of that type of information after its development or creation and include specific provisions concerning the confidentiality of that information.***
- ***In the case of contracts for the provision of services, the supplier undertakes to perform services which may require the use, by that supplier, of special knowledge, skill and expertise but not the transfer of such special knowledge, skill or expertise to the other party.***

— *In most cases involving the supply of know-how, there would generally be very little more which needs to be done by the supplier under the contract other than to supply existing information or reproduce 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 by the supplier in order to perform his contractual obligations. For instance, the supplier, depending on the nature of the services to be rendered, may have to incur salaries and wages for employees engaged in researching, designing, testing, drawing and other associated activities or payments to subcontractors for the performance of similar services.*

**11.4 Examples of payments which should therefore not be considered to be received as consideration for the provision of know-how but, rather, for the provision of services, include:**

- 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,
- payments for an opinion given by an engineer, an advocate or an accountant, and
- **payments for advice provided electronically, for electronic communications with technicians or for accessing, through computer networks, a trouble-shooting database such as a database that provides users of software with non-confidential information in response to frequently asked questions or common problems that arise frequently.**

**11.5 In the particular case of a contract involving the provision, by the supplier, of information concerning computer programming, as a general rule the payment will only be considered to be made in consideration for the provision of such information so as to constitute know-how where it is made to acquire information constituting ideas and principles underlying the program, such as logic, algorithms or programming languages or techniques, where this information is provided under the condition that the customer not disclose it without authorisation and where it is subject to any available trade secret protection.**

**11.6** In business practice, contracts are encountered which cover both know-how and the provision of technical assistance. One example, amongst others, of contracts of this kind is that of franchising, where the franchisor imparts his knowledge and experience to the franchisee and, in addition, provides him with varied technical assistance, which, in certain cases, is backed up with financial assistance and the supply of goods. The appropriate course to take with a mixed contract is, in principle, to break down, on the basis of the information contained in the contract or by means of a reasonable apportionment, the whole amount of the stipulated consideration according to the various parts of what is being provided under the contract, and then to apply to each part of it so determined the taxation treatment proper thereto. If, however, one part of what is being provided constitutes by far the principal purpose of the contract and the other parts stipulated therein are only of an ancillary and largely unimportant character, then it seems possible to apply to the whole amount of the consideration the treatment applicable to the principal part.” [paragraph 45 below includes suggested changes to this last sentence]

### **3.c. Business profits and payments for the use of, or the right to use, industrial, commercial or scientific equipment**

#### *Analysis and conclusions*

21. 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.<sup>4</sup>

#### *i. Digital products*

22. A first question is whether the words “payments for the use of, or the right to use, industrial, commercial or scientific equipment” can apply to payments for time-limited use of a digital product (e.g. category 5 dealing with limited duration software and other digital information licenses).

<sup>4</sup> 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...”.

23. The Committee concluded 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”.<sup>5</sup> Member countries reached that conclusion primarily because digital products are not considered to be “equipment” since the word “equipment” only applies 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). Additional reasons, which may, depending on the circumstances, apply to some or all payments for time-limited use of a digital product, are:

- because digital products cannot be considered as “equipment” since 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, products such as games, music or videos cannot be considered as “industrial, commercial or scientific” (as these examples show, the two preceding reasons would be primarily relevant where the payment is made by a private consumer); or
- because the payments involved in that type of transaction generally 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.

ii. *Computer equipment*

24. In a few transactions the question arises as to whether tangible computer equipment (hardware) is being used by a customer so as to allow the relevant payment to be characterised as “payments for the use of, or the right to use, industrial, commercial or scientific equipment” (see categories 7, 8, 9, 11 and 13 in annex 2).

25. Such characterization is clearly appropriate where, for instance, the payment is for the rental of a computer and not for services. Factors that may indicate the rental of equipment as opposed to a service contract include:

- the customer is in physical possession of the property,
- the customer controls the property,
- the provider does not use the property concurrently to provide significant services to entities unrelated to the service recipient.

26. This is a non-exclusive list of factors. 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.

27. In the case of application service provider transactions, the Committee concluded that these transactions 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.

28. 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 utilise the equipment concurrently with other customers.

<sup>5</sup> New Zealand reserves its position on whether payments for the use of digital products can be treated as payments “for the use of, or the right to use, industrial, commercial or scientific equipment.” New Zealand is currently considering issues relating to the tax treatment of computer software generally.

#### 4. Provision of services

##### *Analysis and conclusions*

29. Whilst the OECD Model Tax Convention does not deal separately with payments for the provision of services, the distinction between these payments and payments made as consideration for the acquisition of property is relevant for certain bilateral conventions as well as for some domestic tax law purposes. The Committee therefore considered it useful to discuss the distinction between the provision of services and transactions resulting in the acquisition 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.

30. The basic distinction between, on the one hand, a transaction resulting in the acquisition of property and, on the other hand, a transaction in services is whether the consideration for the payment is the acquisition of property from the provider. In this regard, a transaction resulting in the acquisition of property should be understood to include a transaction where a digital product (such as a copy of electronic data, a software program, digitised music or video images, and other forms of digital information and content), whether provided on a tangible medium or in the form of a digital signal, is acquired by a customer.

31. Generally speaking, if the customer owns the relevant property after the transaction, but the property was not acquired from the provider, then the transaction should be treated as a services transaction. For example, if one party engages another party to create an item of property that the first party will own from the moment of its creation, then no property will have been acquired by the first party from the other and the transaction should be characterised as the provision of services.

32. If, however, one party acquires property from another party, the transaction should nonetheless be characterised as a services transaction to the extent that the predominant nature of the transaction is the provision of services and the acquisition of property is merely ancillary. This would be the case, for example, where the relevant property itself has little intrinsic value and the provider creates value through the exercise of its particular talents and skills to create a unique result for the acquirer. 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 acquire any form of property from the other party. If the customer does acquire property, such as a report, it most likely will have been created specifically for him and arguably was owned by the customer from the moment of its creation. If, however, the customer acquires 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. Even if the customer obtained the report electronically by downloading it from a database of reports maintained on the vendor's server, the essential consideration would still be to acquire data transmitted in the form of a digital signal for the own use or enjoyment of the acquirer rather than to obtain a service.

#### 5. Technical fees

##### *Analysis and conclusions*

33. The Committee examined how various e-commerce payments would be treated under alternative treaty provisions that allow source taxation of "technical fees".

34. Whilst 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."

35. Alternative formulations of provisions dealing with technical fees typically limit the application of these provisions to some categories of services that could fall within the scope of the definition above.<sup>6</sup> For these reasons, it was decided to restrict the analysis to that definition so as to try to clarify the limits of application of these provisions. In

<sup>6</sup> See, for example, the provision of the India-United States tax convention dealing with "included services".

doing so, the three different types of services referred to in the definition were examined separately, i.e. technical services, managerial services and consultancy services.

*i. Technical services*

36. Services are of technical nature when special skills or knowledge related to a technical field are required for the provision of such services. Whilst techniques related to applied science or craftsmanship would generally correspond to such special skills or knowledge, the provision of knowledge acquired in fields such as arts or human sciences would generally not (the services of restoring an old art work is an example of an exception to this general rule). As an illustration, whilst the provisions of engineering services would be of a technical nature, the services of a psychologist would not.

37. The fact that technology is used in providing a service is not indicative of whether the service is of a technical nature. Similarly, the delivery of a service via technological means does not make the service technical. This is especially important in the ecommerce environment as the technology underlying the internet is often used to provide services that are not, themselves, technical (e.g. offering on-line gambling services through the internet).

38. In that respect, it is crucial to determine at what point the special skill or knowledge is used. Special skill or knowledge may be used in developing or creating inputs to a service business. The fee for the provision of a service will not be a technical fee, however, unless that special skill or knowledge is required when the service is provided to the customer. For example, special skill or knowledge will be required to develop software and data used in a computer game that would subsequently be used in carrying on the business of allowing consumers to play this game on the internet for a fee. Similarly, special skill or knowledge is used to create a troubleshooting database that customers will pay to access over the Internet. In these examples, however, the relevant special skill or knowledge is not used when providing the service for which the fee is paid, i.e. allowing the consumer to play the computer game or consult the troubleshooting database.

39. Many categories of e-commerce transactions similarly involve the provision of the use of, or access to, data and software (see, for example, categories 7, 8, 9, 11, 13, 15, 16, 20 and 21 in annex 2). The service of making such data and software, or functionality of that data or software, available for a fee is not, however, a service of a technical nature. The fact that the development of the necessary data and software might itself require substantial technical skills is irrelevant as the service provided to the client is not the development of that data and software (which may well be done by someone other than the supplier) but rather the service of making the data and software available to that client. For example, the mere provision of access to a troubleshooting database would not require more than having available such a database and the necessary software to access it. A payment relating to the provision of such access would not, therefore, relate to a service of a technical nature.

*ii. Managerial services*

40. Services of a managerial nature are services rendered in performing management functions. The Committee did not attempt to give a definition of management for that purpose but noted that this term should receive its normal business meaning. Thus, it would involve functions related to how a business is run as opposed to functions involved in carrying on that business. As an illustration, whilst the functions of hiring commercial agents would relate to management, the functions performed by these agents (i.e. selling) would not.

41. The comments in paragraphs 37 to 39 above are also relevant for the purposes of distinguishing managerial services from the service of making data and software (even if related to management), or functionality of that data or software, available for a fee. The fact that this data and software could be used by the customer in performing management functions or that the development of the necessary data and software, and the management of the business of providing it to customers, might itself require substantial management expertise is irrelevant as the service provided to the client is neither managing the client's business, managing the supplier's business nor developing that data and software (which may well be done by someone other than the supplier) but rather making the software and data available to that client. The mere provision of access to such data and software does not require more than having available such a database and the necessary software. A payment relating to the provision of such access would not, therefore, relate to a service of a managerial nature.

iii. *Consultancy services*

42. “Consultancy services” refer to services constituting in the provision of advice by someone, such as a professional, who has special qualifications allowing him to do so. It was recognised that this type of services overlapped the categories of technical and managerial services to the extent that the latter types of services could well be provided by a consultant.

## 6. Mixed payments

### *Analysis and conclusions*

43. There are 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). These should be dealt with on the basis of the principles for dealing with mixed contracts which are set out in paragraph 11 of the Commentary on Article 12.

44. It was 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 Committee considered 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.

### *Changes to the Commentary*

45. The Committee therefore concluded that the following changes should be made to the Commentary on Article 12 of the OECD Model Tax Convention:

*Replace the last sentence of paragraph 11 of the Commentary on Article 12 by the following (changes to the existing text appear in strikethrough and bold italics):*

“If, however, one part of what is being provided constitutes by far the principal purpose of the contract and the other parts stipulated therein are only of an ancillary and largely unimportant character, **then the treatment applicable to the principal part should generally be applied to the whole amount of the consideration.** ~~then it seems possible to apply to the whole amount of the consideration the treatment applicable to the principal part.”~~

## **ANNEX 1 – Changes to the Commentary on Article 12 of the OECD Model Tax Convention**

*[Changes to the existing text of the Commentary appear in bold italics for additions and strikethrough for deletions]*

1. Replace paragraph 11 of the Commentary on Article 12 by the following paragraphs 11 to 11.5:

*Replace the last sentence of paragraph 11 of the Commentary on Article 12 by the following:*

“11. In classifying as royalties payments received as consideration for information concerning industrial, commercial or scientific experience, paragraph 2 alludes to the concept of “know-how”. Various specialist bodies and authors have formulated definitions of know-how which do not differ intrinsically. One such definition, given by the “*Association des Bureaux pour la Protection de la Propriété Industrielle*” (ANBPPI), states that “know-how is all the undivulged technical information, whether capable of being patented or not, 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.”

**11.1** 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. It is recognised that the grantor is not required to play any part himself in the application of the formulas granted to the licensee and that he does not guarantee the result thereof.

**11.2** This type of contract thus differs from contracts for 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. **Payments made under the latter contracts generally fall under Article 7.**

**11.3** *The need to distinguish these two types of payments, i.e. payments for the supply of know-how and payments for the provision of services, sometimes gives rise to practical difficulties. The following criteria are relevant for the purpose of making that distinction:*

— *Contracts for the supply of know-how concern information of the kind described in paragraph 11 that already exists or concern the supply of that type of information after its development or creation and include specific provisions concerning the confidentiality of that information.*

— *In the case of contracts for the provision of services, the supplier undertakes to perform services which may require the use, by that supplier, of special knowledge, skill and expertise but not the transfer of such special knowledge, skill or expertise to the other party.*

— *In most cases involving the supply of know-how, there would generally be very little more which needs to be done by the supplier under the contract other than to supply existing information or reproduce 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 by the supplier in order to perform his contractual obligations. For instance, the supplier, depending on the nature of the services to be rendered, may have to incur salaries and wages for employees engaged in researching, designing, testing, drawing and other associated activities or payments to sub-contractors for the performance of similar services.*

**11.4** *Examples of payments which should therefore not be considered to be received as consideration for the provision of know-how but, rather, for the provision of services, include:*

- 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,
- payments for an opinion given by an engineer, an advocate or an accountant, and
- **payments for advice provided electronically, for electronic communications with technicians or for accessing, through computer networks, a trouble-shooting database such as a database that provides users of software with non-confidential information in response to frequently asked questions or common problems that arise frequently.**

**11.5** *In the particular case of a contract involving the provision, by the supplier, of information concerning computer programming, as a general rule the payment will only be considered to be made in consideration for the provision of such information so as to constitute know-how where it is made to acquire information constituting ideas and principles underlying the program, such as logic, algorithms or programming languages or techniques, where this information is provided under the condition that the customer not disclose it without authorisation and where it is subject to any available trade secret protection.*

**11.6** In business practice, contracts are encountered which cover both know-how and the provision of technical assistance. One example, amongst others, of contracts of this kind is that of franchising, where the franchisor imparts his knowledge and experience to the franchisee and, in addition, provides him with varied technical assistance, which, in certain cases, is backed up with financial assistance and the supply of goods. The appropriate course to take with a mixed contract is, in principle, to break down, on the basis of the information contained in the contract or by means of a reasonable apportionment, the whole amount of the stipulated consideration according to the various parts of what is being provided under the contract, and then to apply to each part of it so determined the taxation treatment proper thereto. If, however, one part of what is being provided constitutes by far the principal purpose of the contract and the other parts stipulated therein are only of an ancillary and largely unimportant character, **then the treatment applicable to the principal part should generally be applied to the whole**

*amount of the consideration*, then it seems possible to apply to the whole amount of the consideration the treatment applicable to the principal part.

2. Add the following paragraphs 17.1 to 17.4 immediately after paragraph 17 of the Commentary on Article 12:

*“17.1 The principles expressed above as regards software payments are also applicable as regards transactions concerning other types of digital products such as images, sounds or text. The development of electronic commerce has multiplied the number of such transactions. In deciding whether or not payments arising in these transactions constitute royalties, the main question to be addressed is the identification of that for which the payment is essentially made.*

*17.2 Under the relevant legislation of some countries, transactions which permit the customer to electronically download digital products may give rise to use of copyright by the customer, e.g. because a right to make one or more copies of the digital content is granted under the contract. Where the consideration is essentially for something other than for the use of, or right to use, rights in the copyright (such as to acquire other types of contractual rights, 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, network or other storage, performance or display device, such use of copyright should not affect the analysis of the character of the payment for purposes of applying the definition of “royalties”.*

*17.3 This is the case for transactions that permit the customer (which may be an enterprise) to electronically download digital products (such as software, images, sounds or text) for that customer’s own use or enjoyment. In these transactions, the payment is essentially for the acquisition of data transmitted in the form of a digital signal and therefore does not constitute royalties but falls within Article 7 or Article 13, as the case may be. To the extent that the act of copying the digital signal onto the customer’s hard disk or other non-temporary media involves the use of a copyright by the customer under the relevant law and contractual arrangements, such copying is merely the means by which the digital signal is captured and stored. This use of copyright is not important for classification purposes because it does not correspond to what the payment is essentially in consideration for (i.e. to acquire data transmitted in the form of a digital signal), which is the determining factor for the purposes of the definition of royalties. There also would be no basis to classify such transactions as “royalties” if, under the relevant law and contractual arrangements, the creation of a copy is regarded as a use of copyright by the provider rather than by the customer.*

*17.4 By contrast, transactions where the essential consideration for the payment is the granting of the right to use a copyright in a digital product that is electronically downloaded for that purpose will give rise to royalties. This would be the case, for example, of a book publisher who would pay to acquire the right to reproduce a copyrighted picture that it would electronically download for the purposes of including it on the cover of a book that it is producing. In this transaction, the essential consideration for the payment is the acquisition of rights to use the copyright in the digital product, i.e. the right to reproduce and distribute the picture, and not merely for the acquisition of the digital content.”*

## ANNEX 2 – Analysis of various categories of typical e-commerce transactions

1. This annex illustrates how the conclusions presented in sections 1 to 4 apply in the case of some typical electronic commerce transactions.

### Category 1: Electronic order processing of tangible products

#### Definition

*The customer selects an item from an online catalogue 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 catalogue. The product is physically delivered to the customer by a common carrier.*

### **Analysis and conclusions**

2. Since it does not raise any difficulty as regards treaty characterisation, this category of transaction provides a useful starting point to understand other examples. 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 catalogue 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 catalogue. The digital product is downloaded onto the customer's hard disk or other non-temporary media.*

#### **Analysis and conclusions**

3. This category of transaction raises the fundamental characterisation issue discussed in paragraphs 10 to 12 of section 1 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. In the case of transactions that permit the customer to electronically download digitised products (such as software, images, sounds or text) for the customer's own use or enjoyment, the payment is made to acquire data transmitted in the form of a digital signal. Since this constitutes the essential consideration for the payment, that payment cannot be considered as royalties as a payment made for the use or the right to use a copyright. To the extent that the act of copying the digital signal onto the customer's hard disk or other non-temporary media (including transfers to other storage, performance or display devices) constitutes the use of a copyright under the relevant law and contractual arrangements, this is merely an incidental part of the process of capturing and storing the digital signal. This incidental part is not important for classification purposes because it does not correspond to the essential consideration for the payment (i.e. to acquire data transmitted in the form of a digital signal), which is the determining factor for the purposes of the treaty definition of royalties.

### **Category 3: Electronic ordering and downloading of digital products for purposes of commercial exploitation of the copyright**

#### **Definition**

*The customer selects an item from an online catalogue 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 catalogue. 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**

4. This category of transaction illustrates a case where 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. The cus-*

tomers does not acquire the right to commercially exploit the copyright in the digital product or in the update or add-on.

### **Analysis and conclusions**

5. This category of transaction should be treated
  - like the transactions described in category 1 above if the updates and add-ons are delivered on a tangible medium;
  - like the transactions described in category 2 above if the updates and add-ons are delivered electronically.
6. Since both categories 1 and 2 would give rise to payments falling under Article 7, payments made by the customer in this category of transaction should therefore be treated similarly.

## **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**

7. Under the OECD Model, that transaction should be treated exactly as transactions falling under categories 1 or 2 so that the payment to the commercial provider of the limited duration digital product would fall under Article 7 (Business Profits).
8. Also, if 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”, such payments cannot be considered as payments “for the use of, or the right to use, industrial, commercial or scientific equipment” for the reasons set out in paragraphs 22 and 23 of section I above.

## **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**

9. Whilst some Member countries view this type of transaction as contracts for services and others view them as being similar to the transactions referred to in categories 2 and 5, under both views the payments made in these transactions fall under Article 7 as business profits.

## **Category 7: Application hosting - separate license**

### **Definition**

*A customer has a perpetual license to use a software product. The customer enters into a contract with a provider whereby the provider loads the software copy on servers owned and operated by the provider. The provider supplies technical support to protect against failures of the system. The customer 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 provider's server. This type of arrangement could apply, for example,*

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*for financial management, inventory control, human resource management or other enterprise resource management software applications.*

### **Analysis and conclusions**

10. Under the OECD Model, this type of transaction gives rise to business profits falling under Article 7.

11. 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.

12. As discussed in paragraphs 24 to 28 of section 1 above, 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 utilise the equipment concurrently with other customers.

13. Another issue is 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”. To the extent that main service being provided is merely that of storing the data and software of customers, this service is akin to mere warehousing and the performance of that function does not require the direct exercise of any special technical skill or knowledge.

## **Category 8: Application hosting - bundled contract**

### **Definition**

*For a single, bundled fee, the customer 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 provider, and provides technical support for the hardware and software. The customer 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 provider's server. The contract is renewable annually for an additional fee.*

### **Analysis and conclusions**

14. Under 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.

15. Pursuant to the existing paragraph 11 of the Commentary on Article 12, however, the need to separate the payment into various components could arise when applying bilateral conventions that include the alternative provisions referred to in the previous category (see paragraphs 43 to 45 of section 4 above). This would be the case to the extent that part of the payment relates to the provision of technical support for the software that would constitute services of a technical nature. In that case, that part would be treated differently from the parts relating to allowing access to one or more software applications and hosting such software applications as such functions do not require the application of special skills or knowledge (they essentially require owning the relevant equipment and software rights that are made available).

## **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**

16. As regards the payment made by the customer, the issues 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**

17. 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. It is 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). If, however, 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 characterisation 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**

18. Under the OECD Model, this type of transaction gives rise to business profits falling under Article 7. 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 not give rise to these two types of income under the circumstances and for the reasons presented 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**

19. The remarks expressed in paragraphs 43 to 45 of section 4 above as regards mixed contracts, which refer to the principles set out in paragraph II 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**

20. Under the OECD Model, this type of transaction gives rise to business profits falling under Article 7. 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 not give rise to these two types of income under the circumstances and for the reasons presented 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**

21. 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.

22. Based on paragraphs 14 to 19 of section 1 above and, in particular, the factors listed in paragraphs 15 and 16, the payment for online advice, communications with technicians and using the trouble-shooting database should not be considered as a payment for “information concerning industrial, commercial or scientific experience” (know-how) so as to constitute royalties since that payment is clearly for actual services being performed on demand rather than for the provision of know-how.

23. Whilst 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 II 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, 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.

24. The remarks in paragraphs 43 to 45 of section 4 above, which deal with mixed contracts, would be relevant if the contract were considered to cover the provision of both services and know-how.

25. A last issue is how the payment arising in this type of transaction would be treated under alternative treaty provisions that allow source taxation of “technical fees”.

26. Whilst the provision of online advice through communications with technicians may require the application of special skill and knowledge and might therefore constitute services of a technical nature, the mere provision of access to a troubleshooting database would not require more than having available such a database and the necessary software to access it. The part of the payment relating to the provision of such access would not, therefore, relate to a service of a technical nature.

### **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**

27. The payment arising from this type of transaction would fall under Article 7. Some Member countries reach that conclusion because, given that the principal value of such a database would be the ability to search and extract the documents, these countries 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.

28. Another issue is whether such payment could be considered as a payment for services “of a technical nature” under the alternative provisions on technical fees previously referred to. Providing a client with the use of search and retrieval software and with access to a database does not involve the exercise of special skill or knowledge when the software and database is delivered to the client. The fact that the development of the necessary software and database would itself require substantial technical skills was found to be irrelevant as the service provided to the client was not the development of the software and database (which may well be done by someone other than the supplier) but rather making the completed software and database available to that client.

### **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 catalogue or index.*

#### **Analysis and conclusions**

29. These transactions involve the same characterisation issues as those described in the previous category. Thus, the payment arising from this type of transaction falls under Article 7 and is not a technical fee for the same reason.

### **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 “impres-*

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*sions” (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**

30. 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**

31. Again, 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.

32. As some of these transactions may involve the provision of technical, managerial or consultancy services, the issue also arises whether these could be considered as services “of a technical nature” under the alternative provisions on technical fees that have been previously referred to. To the extent that the services were rendered by someone acting as a consultant, they would constitute services of a consultancy nature so as to fall within the definition quoted in paragraph 34 of section 3.

## **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**

33. 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 custompackaged format tailored to their specific needs.*

### **Analysis and conclusions**

34. This type of transaction raises basically the same issues as the transaction described under category 15 above. The payments arising from these transactions therefore constitute business profits falling under Article 7 and are not technical fees for the same reason.

**Category 21: Access to an interactive web site****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. This example differs from the previous one in that the principal value of the site to subscribers is interacting with the site while online as opposed to getting a product or obtaining services from the site.*

**Analysis and conclusions**

35. 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. It should be noted, however, that any payment to the owner of the copyright in the digital content 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 catalogues of multiple merchants on its computer servers. Users of the web site can select products from these catalogues 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**

36. 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**

37. 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*

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*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**

38. 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**

39. 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**

40. The subscription or advertising fees that would be received in these transactions would constitute business profits falling under Article 7.

## **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**

41. In that type of transactions, the web site or network operator is providing a commercial service for a fee and its income should be characterised 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.

## Category 28: Subscription to a web site allowing the downloading of digital products

### Definition

The provider makes available to subscribers a web site featuring copyrighted digital content (e.g. music). Subscribers pay a fixed periodic fee for access to the site. Unlike category 21, the principal value of the site to subscribers is the possibility to download these digital products.

### Analysis and conclusions

42. The subscription fee paid in this type of transaction would fall under Article 7. As explained in paragraph 3 above, transactions that permit the customer to electronically download digitised products (i.e. music in this case) for the customer's own use or enjoyment do not give rise to royalties. This category of transaction is closer to category 2 than to category 21 since the essential consideration for the payment is not the temporary interaction with the site but, rather, the acquisition of the music data transmitted in the form of a digital signal.

## ANNEX 3 – Observations by Greece and Spain

### Greece

1. We do not adhere to the interpretation in the fifth dash of paragraph 11.4 [which the report proposes to add to the Commentary on Article 12 – see annex 1] and we take the view that all relevant payments are falling within the scope of Article 12.
2. We do not adhere to the interpretation in paragraphs 17.2 and 17.3 [which the report proposes to add to the Commentary on Article 12 – see annex 1] because the payments related to the downloading of computer software ought to be considered as royalties even if those products are acquired for the personal or business use of the purchaser.

### Spain

3. The note includes new paragraphs after paragraph 17 of the Commentary on Article 12, in relation with electronic downloading of digital products and other similar categories appeared with the electronic commerce. In order to keep a coherent stance, Spain understands that the observation made to paragraphs 14 and 15 of the Commentary on Article 12 is also applicable to new paragraphs 17.1 to 17.4.
4. Nevertheless, Spain would like to take advantage of this opportunity to reconsider its position on the issue of the software and the royalties, on two different grounds:
  - On our view, anyone who is using software for a business purpose should be deemed to be paying a royalty. Thus, it does not matter if that use implies to reproduce and sell, on his turn, the rights to new acquirers or if the software is used in the acquirer's business process as a tool for developing its activity. When there is not business but personal use we agree with the most extended view of not considering these payments as royalties.
  - There is a difference to be made between standardised software and the software which is adapted to any extent to the acquirer's individual characteristics. In the first case, when someone acquires standardised software for his personal or business use, even though he is acquiring the right to use that software, in fact, he is acquiring an object, something sold on a homogenous and massive basis to any purchaser, and that should be treated as a merchandise under Article 7. This does not happen in the second case, thus, it should be treated, in our opinion, under Article 12.
5. According with these considerations and with the need of coherence in relation with the new incorporations to the Model, Spain would like its current Observation on the Commentary on Article 12 to be substituted by the following:

*“Spain does not adhere to the interpretation in paragraphs 14, 15 and 17.1 to 17.4. Spain holds the view that payments relating to software fall within the scope of the Article where less than the full rights to software are transferred either if the payments are in consideration for the right to use a copyright on software for commercial exploitation or if they relate to software acquired for the business use of the purchaser, when, in this last case, the software is not absolutely standardised but somehow adapted to the purchaser.”*