

TREATY CHARACTERIZATION ISSUES ARISING FROM ELECTRONIC COMMERCE

Introduction

1. The TAG on Treaty Characterization of Electronic Commerce Payments has received the mandate “to examine the characterization of various types of electronic commerce payments under tax conventions with a view to providing the necessary clarifications in the Commentary.”

2. Pursuant to that mandate, the TAG has prepared this document, which identifies various categories of typical e-commerce transactions, discusses the treaty characterization issues arising from these transactions and presents the preliminary conclusions of the Group, and their underlying analysis, on how the payments arising from these transactions should be classified for tax treaty purposes.

3. In presenting this document for comments, the TAG wishes to stress the following:

- The TAG's mandate referred to the interpretation of existing treaty provisions. While the TAG did discuss the policy underlying these provisions for purposes of determining their object and purpose, it does not consider that its role is to recommend modifications of existing treaty policies.
- The document does not attempt to list exhaustively all e-commerce transactions. The TAG has selected transactions that are either fairly common or which have already raised treaty characterization issues.
- In carrying on its mandate, the TAG has not restricted itself to characterization issues arising under the OECD Model Tax Convention but has attempted to also discuss commonly used alternative provisions. For instance, while the treatment of royalties and business profits is similar under the OECD Model Tax Convention, many bilateral conventions include provisions that provide a right for the State of source to tax royalties even if the recipient does not have, in that State, a permanent establishment to which the right in respect of which the royalties is paid is effectively connected. Similarly, the TAG has examined treaty provisions that allow for source taxation of technical fees (including what are described in some treaties as payments for services of a technical nature) or payments for the use, or the right to use, industrial, commercial or scientific equipment even where the equipment is not effectively connected to a permanent establishment in that State. Where a transaction raises issues of whether a payment is a technical fee or for the right to use industrial, commercial or scientific equipment, those issues will be discussed. Therefore, if the issue is not discussed in the analysis of a transaction, the Group concluded that there was no basis for such a characterization.
- The views expressed in this document are still preliminary and members of the TAG are particularly interested in alternative approaches or arguments concerning the issues discussed herein.

1. Electronic order processing of tangible products

Definition

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

Analysis and conclusions

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

2. Electronic ordering and downloading of digital products

Definition

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

Analysis and conclusions

5. The Group found that this category of transaction raised a fundamental characterization issue, i.e. the distinction between the treaty definition of "royalties" and business profits. It spent considerable time discussing that issue, including the proposal that royalty characterization could not arise in the absence of a transfer of rights to allow a commercial exploitation of the copyright by the transferee, but could not reach a unanimous view.

6. The majority considers that, in this type of transaction, the payments made by the customer would not constitute royalties but, rather, would fall within Article 7 as business profits. The members who share that position view this type of transaction as equivalent to the first category of transaction and consider that the mere fact that a digital product is delivered electronically should not change the treaty classification of the transaction.

7. Under that view, the act of copying the product onto the customer's hard disk or other non-temporary media is merely an incidental part of the transaction that is not important for classification purposes. The purpose of the transaction, for both the customer and the provider, is to deliver a digital product that the customer may use and not to allow the customer to use the copyright in that product, and the method of delivery is chosen by the provider and the customer merely to create distribution cost and time efficiencies.

8. The majority notes that the issue of electronic delivery of software is already dealt with in paragraph 14.1 of the Commentary on Article 12, as recently amended. That paragraph states that "The method of transferring the computer program to the transferee is not relevant. For example, it does not matter whether the transferee acquires a computer disk containing a copy of the program or directly receives a copy on the hard disk of her computer via a modem connection." According to the majority, there is no policy or legal interpretation argument that justifies treating differently digital products other than software. Furthermore, treating a digital product delivered electronically and a digital product delivered on tangible medium in the same way is consistent with the framework condition of neutrality, which states that the taxation of an e-commerce transaction should not differ from the taxation of the analogous transaction in traditional form.

9. The minority view, however, is that, in this type of transaction, the payment made by the customer falls within the treaty definition of "royalties". The members who put forward this view argue that the payment cannot be seen as made to acquire a copy of the software or other digital product since that copy does not exist until it is made by the customer by copying to the customer's hard disk or other non-temporary media. Since the customer makes the copy, the payment is made in order to acquire the right to make that copy and the payment must therefore be considered to be "for the use or the right to use a copyright..." so as to constitute a royalty. They further argue that in this type of transaction there is no property or service, other than the right to make the copy, that is acquired by the customer from the provider. These members consider that it cannot be said that the copying is an incidental part of the transaction, as it constitutes the entirety of the transaction. They conclude, therefore, that the payment is wholly for the right to copy and thus constitutes a royalty.

3. Electronic ordering and downloading of digital products for purposes of copyright exploitation

Definition

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

Analysis and conclusions

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

4. Updates and add-ons

Definition

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

Analysis and conclusions

11. The Group agrees that this category of transaction should be treated
- like the transactions described in section 1 above if the updates and add-ons are delivered on a tangible medium;
 - like the transactions described in section 2 above if the updates and add-ons are delivered electronically.
12. Thus, while the Group unanimously agrees that the payment made by the customer would fall under Article 7 if the updates and add-ons are delivered on a tangible medium, the minority view described in section 2 does not agree with the majority that the result is the same if these are delivered electronically and considers that the payment then constitutes a royalty.

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

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

1) *Product provided on a tangible medium*

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

15. Unlike the OECD Model as currently worded, however, 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”. In 1992, these words were deleted from the definition of royalties in

the OECD Model. Paragraph 9 of the Commentary on Article 12 indicates that this was done 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...”

16. 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”, the issue arises whether these words can be applied to a payment for a limited duration digital product provided on a tangible medium. Since the product covered by this category of transaction is only made available for a limited time, it could be argued that this is equivalent to a lease so as to fall under such definition.

17. For this to be the case, however, three conditions would have to be met:

- first, a limited duration digital product provided on a tangible medium would have to be considered as "equipment";
- second, it would have to be considered as “industrial, commercial or scientific”;
- third, the payment for that product would have to be considered as having been made “for the use, or the right to use” that product.

“Equipment”

18. The majority view is that such a product could not be considered as “equipment”. Some members reach that conclusion because the word “equipment” can only apply to a tangible product and not to digital product. The fact that the digital product is provided on a tangible medium would not, according to these members, 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. Other members reach the same conclusion by arguing that 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.

19. Some members of the Group, however, conclude that the word equipment would be broad enough to apply where the digital content is provided on a tangible medium as they consider that the digital content and the medium are inseparable. One member also consider that a digital product can, in itself, constitute "equipment" regardless of whether or not it is provided on a tangible medium, because the digital product resembles more a tangible than an intangible product.

“Industrial, commercial or scientific”

20. A majority of the members also consider that such product cannot be viewed as “industrial, commercial or scientific”, at least when provided to the private consumer. Based on the nature of the product or the purpose of its acquisition by the user, these members believe that products such as games, music or videos cannot be considered as “industrial, commercial or scientific”. Some members suggest, however, that such products can be characterized as commercial for a provider that is in the business of providing them.

“Payments for the use, or the right to use”

21. The Group did not reach a conclusion as to whether the payments involved in that type of transaction could be considered to be “for the use, or the right to use” the product acquired. Some members argue that the words are broad enough to apply in this case and cover most situations where the agreement allowing use of the product is for a period that is less than the useful life of the original. Others take the position that these words do not apply to a payment made to definitively acquire a property designed to have a short useful life, e.g. where someone acquires a video game CD that is programmed to become unusable after a certain period of time. These members consider that in such case, there is a transfer of ownership despite the time limitation. One reason for this is that the digital product has no value for the seller after the period of use (the seller can make a new copy at no extra cost).

2) *Downloaded products*

22. The differences of views expressed in the case of digital products that are downloaded electronically (see section 2 above) are also relevant in cases where those products have a limited duration. Under the current wording of the OECD Model, a majority of the Group takes the view that payments for the latter would fall under Article 7 (Business Profits) while a minority argues that they would be covered by Article 12 (Royalties).

23. In bilateral conventions where the definition of royalties covers “payments for the use of, or the right to use, industrial, commercial or scientific equipment” most members believe that in the case of products that are downloaded electronically, the fact that the product is not delivered on tangible media such as CD-rom makes it impossible to view the digital product as “equipment”. Some members, however, did not share that view and argued that the word “equipment” may apply to downloaded digital products stored on the computer's hard disk on the basis that the functional result is identical regardless of whether the program copy is delivered on a tangible medium or downloaded and copied on the user's permanent medium.

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

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

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

7. Application Hosting - Separate License

Definition

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

Analysis and conclusions

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

27. 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.

28. While a few members believe that this could be the case, most members disagree noting that, in these transactions, the host is not renting its equipment to the customer and continues to operate and maintain it (in many cases, the user does not even know which particular server is used to run his application).

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

8. Application Hosting - Bundled Contract

Definition

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

Analysis and conclusions

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

Article 7. Members who adopt the minority view described in section 2 also agree that, since the user in this example does not obtain the right to copy the software onto the user's hard drive or other non-temporary media, the royalty issues described in section 2 do not arise.

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

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

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

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

33. The Group agrees that this type of transaction, being essentially for the provision of software to be used in the business of the transferee, raises the same issues as those arising from transactions covered by section 2. It does not consider that the outcome should be affected by the different basis on which the payment is computed and made.

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

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

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

35. The Group agrees that the principles for dealing with mixed contracts, as set out in paragraph 11 of the Commentary on Article 12, apply to such transactions. Where, under those principles, part of the payment is regarded to be for the provision of technical support, the issues described in section 14 below as regards alternative treaty provisions that allow source taxation of “technical fees” will arise.

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

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

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

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

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

39. The Group agrees that online advice, communications with technicians and using the trouble-shooting database, would clearly involve actual services being performed on demand rather than the provision of know-how.

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

41. The Group notes that the last part of paragraph 11 of the Commentary on Article 12, which deals with mixed contracts, would be relevant if the contract were considered to cover the provision of both services and know-how.

42. The Group finally discussed how the payment arising in this type of transaction would be treated under alternative treaty provisions that allow source taxation of "technical fees".

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

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

44. Given the wide scope of this definition, the Group agrees that it would be difficult to see how services provided under the type of transaction described above would not constitute services "of a technical nature".

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

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

46. As many members consider that these transactions involve essentially the provision of services, the Group also addressed the issue of whether these could be considered as services "of a technical nature" under the alternative provisions on technical fees referred to in the example above. Many members agreed that this would be the case but a few argued that searching and retrieval services were not, in themselves, of a technical nature, even though the process through which these services were provided involved substantial technology in the transactions under consideration.

16. Delivery of exclusive or other high-value data

Definition

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

Analysis and conclusions

47. The Group agrees that these transactions involve the same characterization issues as those described in the previous section. The majority therefore believes that the payment arising from this type of transaction would fall under Article 7. However, some members who share the minority view described in section 2 would distinguish the two types of transactions on the basis that, here, the primary consideration for the payment is no longer for the provision of search and extract services but, rather, for the right to reproduce valuable data. These members would therefore consider that, unlike the transactions covered by the previous section, this type of transactions gives rise to royalties.

17. Advertising

Definition

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

Analysis and conclusions

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

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

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

50. As these transactions involve the provision of services, the Group also addressed the issue of whether these could be considered as services “of a technical nature” under the alternative provisions on technical fees that have been previously referred to. The Group agrees that, as described above, the services involved are clearly of a “technical [...] or consultancy nature” so as to fall under the definition of “technical fees” that is quoted above.

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

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

20. Information delivery

Definition

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

Analysis and conclusions

52. The Group agrees that this type of transactions raises basically the same issues as those described under section 15 above. Most members of the Group therefore consider that the payments arising from

these transactions constitute business profits falling under Article 7 but some members who adopt the minority view described in section 2 would treat these payments as royalties.

21. Subscription-based interactive web site access

Definition

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

Analysis and conclusions

53. The Group agrees that the subscription fee paid in this type of transactions would constitute a payment for services. As that payment is mainly for the interaction with the site for purposes of the personal enjoyment of the user and not for the provision of any service of a technical, managerial or consultancy nature, it would not, under the previously quoted definition of “technical fees”, fall under the alternative provisions covering these types of payments.

22. Online shopping portals

Definition

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

Analysis and conclusions

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

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

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

24. Sales referral programs

Definition

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

Analysis and conclusions

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

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

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

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

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