TAX TREATMENT OF PAYMENTS FOR DIGITAL SERVICES.

The following draft provision and its Commentary have been prepared in accordance with the outcomes of the 20th session of the Committee, concerning the drafting of a provision that would allow the source taxation of income from the rendering of automated digital services.

New Article 12B – INCOME FROM AUTOMATED DIGITAL SERVICES

1. Income from automated digital services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, income from automated digital services arising in a Contracting State may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the income is a resident of the other Contracting State, the tax so charged shall not exceed ____ percent *(the percentage is to be established through bilateral negotiations)* of the gross amount of the income.

3. Notwithstanding the provisions of paragraph 2, the beneficial owner of the income from automated digital services referred to in that paragraph may require the Contracting State where the income from automated digital services arises, to subject its qualified profits from automated digital services for the fiscal year concerned to taxation at the tax rate provided for in the domestic laws of that State. For the purpose of this paragraph, the qualified profits shall be 30 percent of the amount resulting from applying the beneficial owner's profitability ratio or the profitability ratio of its automated digital business segment, if available, to the gross annual revenue from automated digital services derived from the Contracting State where such income arises. Where the beneficial owner belongs to a multinational group, the profitability ratio to be applied shall be that of the group or, if available, of the business segment of the group relating to income covered by this Article.

4. The term "income from automated digital services" as used in this Article means any payment in consideration for any service provided on the internet or an electronic network requiring minimal human involvement from the service provider. The term "income from automated digital services" does not, however, include payments qualifying as 'fees for technical services' under Article 12A.

5. The provisions of paragraphs 1, 2 and 3 shall not apply if the beneficial owner of the income from the rendering of automated digital services, being a resident of a Contracting State, carries on business in the other Contracting State in which the income from automated digital services arises through a permanent establishment situated in that other State, or performs in the other Contracting State independent personal services from a fixed base situated in that other State, and the income from automated digital services are effectively connected with:

(a) such permanent establishment or fixed base, or

(b) business activities referred to in (c) of paragraph 1 of Article 7.

In such cases the provisions of Article 7 or Article 14, as the case may be, shall apply.

6. For the purposes of this Article, subject to paragraph 7, income from automated digital services shall be deemed to arise in a Contracting State if the payer is a resident of that State or if the person paying the income, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to make the payment was incurred, and such payments are borne by the permanent establishment or fixed base.

7. For the purposes of this Article, income from automated digital services shall be deemed not to arise in a Contracting State if the payer is a resident of that State and carries on business in the other Contracting State through a permanent establishment situated in that other State or performs independent personal services through a fixed base situated in that other State and such expenses are borne by that permanent establishment or fixed base.

8. Where, by reason of a special relationship between the payer and the beneficial owner of the income from automated digital services or between both of them and some other person, the amount of the income, having regard to the services for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the income shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Commentary on new Article 12 B

INCOME FROM AUTOMATED DIGITAL SERVICES

A. General considerations

1.With the rapid changes in modern economies, particularly with respect to cross-border services, it is now possible for an enterprise resident in one State to be substantially involved in another State's economy without a permanent establishment or fixed base in that State and without any substantial physical presence in that State. In particular, with the advancements in means of communication and information technology, an enterprise of one Contracting State can provide substantial services to customers in the other Contracting State and therefore maintain a significant economic presence in that State without having any fixed place of business in that State and without being present in that State for any substantial period. The OECD/G20 Base Erosion and Profit Shifting Project, Action 1: Final Report "Addressing the Tax Challenges of the Digital Economy" (2015) illustrates the difficulties faced by tax policy makers and tax administrations in dealing with the new digital business models made available through the digital economy. The Report did not recommend, for the time being, a withholding tax on digital transactions (which include digital cross border services); nor did it recommend a new nexus for taxation in the form of a significant economic presence test. However, it was recognized that countries were free to include such provisions in their tax treaties, among other additional safeguards against BEPS.

2. As a result of these considerations, the United Nations Committee of Experts identified income from automated digital services as a matter of priority to be dealt with as part of its larger project on the taxation of income from services on one hand and to address the tax challenges due to digitalization of economies on other hand, under the United Nations Model Convention. After considerable study and debate, having due regard to all the arguments for and against the shift of taxing rights with regards to services, the Committee decided to add a new article to the United Nations Model Convention expanding the taxing rights for States from which payments for automated digital services are made.

3. Article 12B was added to the United Nations Model Convention in 20XX to allow a Contracting State to tax income from certain digital services paid to a resident of the other Contracting State on a gross basis at the rate negotiated bilaterally and specified in paragraph 2 of the Article.. Under this Article, a Contracting State is entitled to tax payments for automated digital services if the income is paid by a resident of that State or by a non-resident with a permanent establishment or fixed base in that State and the payments are borne by the permanent establishment or fixed base. Income from automated digital services are defined to mean payments for services provided on the internet or an electronic network requiring minimal human involvement from the service provider. Until the addition of Article 12B, income from automated digital services, derived by an enterprise of a Contracting State was taxable exclusively by the State in which the enterprise was resident unless the enterprise carried on business through a permanent establishment in the other State (the source State) or provided professional or independent personal services through a fixed base in the source State

4. Before the introduction of Article 12B, countries were faced with more restrictive rules of application when digital services were provided cross border. In general, the rules under Article 7, together with Article 5, and Article 14 of the United Nations Model Convention give limited scope

for taxing income from such services, in particular without a fixed base or permanent establishment in the State of source. As noted in these Commentaries, countries have different interpretations of those rules, which can make their application difficult for all parties.

5. The inability of countries to tax income from automated digital services provided by non-resident providers under the provisions of the United Nations Model Convention before the addition of Article 12B may have given non-resident service providers, in certain circumstances, a tax advantage over domestic service providers. Income from automated digital services provided by domestic service providers is subject to domestic tax at the ordinary rate applicable to business profits. In contrast, as indicated above, non-resident service providers would not have been subject to any domestic tax if they did not have a permanent establishment or fixed base in that country, and they might have been subject only to low taxes (or no tax at all) on the income earned in their country of residence.

6. The taxation of income from automated digital services on a gross basis under Article 12B may result in excessive or double taxation. However, the possibility that payments in consideration of automated digital services may be subject to excessive or double taxation is reduced or eliminated under Article 23 (Methods for the Elimination of Double Taxation). In addition, the possibility of excessive or double taxation can be taken into account by having a modest rate of tax on income from automated digital services under paragraph 2 of Article 12B. Moreover, paragraph 3 allows the non-resident provider to require taxation on a net basis by following the global profitability ratio of the beneficial owner or the multinational group to which it belongs to.

7. Article 12B allows payments in consideration for automated digital services to be taxed by a Contracting State on a gross basis. Many developing countries have limited administrative capacity and need a simple, reliable and efficient method to enforce tax imposed on income from services derived by non-residents. A withholding tax imposed on the gross amount of payments made by residents of a country, or non-residents with a permanent establishment or fixed base in the country, is well established as an effective method of collecting tax imposed on non-residents. Such a method of taxation may also simplify compliance for enterprises providing services in another State since they would not be required to compute their net profits or file tax returns, unless they themselves opt for net income basis taxation.

8. Article 12B does not require any threshold, such as a permanent establishment, fixed base, or minimum period of presence in a Contracting State as a condition for the taxation of income from automated digital services. In this regard, modern methods for the delivery of services allow non-residents to perform substantial services for customers in the other country with little or no presence in that country. This ability to derive income from a country with little or no presence there, combined with concerns about the base-erosion and profit-shifting aspects, is considered by a majority of the members of the Committee to justify source taxation of income from automated digital services, also in scenarios where there is no physical presence in the source jurisdiction.

9. Where income from automated digital services are dealt with in both Article 12B and Article 7, paragraph 6 of Article 7 provides that the provisions of Article 12B prevail. However, this priority for Article 12B does not apply if the beneficial owner of the income from automated digital services carries on business through a permanent establishment in the Contracting State in which the income arise, and those services are effectively connected with the permanent establishment or business activities referred to in (c) of paragraph 1 of Article 7. In this situation, paragraph 5 of Article 12B provides that the provisions of Article 7 apply instead of Article 12B.

10. Due the nature of the automated digital services, it is unlikely that income from automated digital services are dealt with in both Article 12B and Article 14. However, if the beneficial owner of the income performs independent personal services in the Contracting State in which the income from automated digital services arise through a fixed base situated in that State and the automated digital services are effectively connected with the fixed base, Article 12B, paragraph 5 provides that the provisions of Article 14 would apply instead of Article 12B

B. Commentary on the paragraphs of Article 12B

Paragraph 1

11. This paragraph establishes that income from automated digital services arising in one Contracting State and paid to a resident of the other Contracting State may be taxed in the other Contracting State. It does not, however, provide that such income is taxable exclusively by the State of residence.

12. The expression “income from automated digital services” is defined in paragraph 4 to mean any “payment” in consideration for any service provided on the internet or an electronic network requiring minimal human involvement from the service provider. The term “payment” has a broad meaning consistent with the meaning of the related term “paid” in Articles 10 and 11. As indicated in paragraph 3 of the Commentary on Article 10 (quoting paragraph 7 of the Commentary on Article 10 of the OECD Model Convention) and paragraph 6 of the Commentary on Article 11 (quoting paragraph 5 of the Commentary on Article 11 of the OECD Model Convention), the concept of payment means the fulfilment of the obligation to put funds at the disposal of the service provider in the manner required by contract or custom.

13. Article 12B deals only with income from automated digital services arising in a Contracting State and paid to a resident of the other Contracting State. It does not, therefore, apply to income from services arising in a third State. Paragraph 6 and paragraph 7 specify when income from automated digital services are deemed to arise in a Contracting State and deemed not to arise in a Contracting State, respectively. However, unlike Articles 10 and 11, which do not apply to dividends paid by a company resident in a third State or interest arising in a third State, Article 12B applies to income from automated digital services paid by a resident of a Contracting State or a third State that are borne by a permanent establishment or fixed base that the resident has in the other Contracting State.

Paragraph 2

14. This paragraph lays down the principle that the Contracting State in which income from automated digital services arise may tax those payments in accordance with the provisions of its domestic law. However, if the beneficial owner of the income is a resident of the other Contracting State, the amount of tax imposed by the State in which the income from automated digital services arises may not exceed a maximum of percent of the gross amount of the payments, as may be negotiated.

15. When considered in conjunction with Article 23 (Methods for the Elimination of Double Taxation), paragraph 2 establishes the primary right of the country in which income from automated digital services arises to tax those payments in accordance with its domestic law (subject to the limitation on the maximum rate of tax if the beneficial owner of the income is a resident of the other Contracting State). Accordingly, the country in which the recipient of the income is resident is obligated to prevent double taxation of those payments. Under Article 23 A or 23 B, the residence country is required to provide relief from double taxation through the exemption from tax of the income from automated digital services or the granting of a credit against tax payable to the residence country on the income from automated digital services for any tax imposed on such income by the other Contracting State in accordance with Article 12B. In this regard, where a country applies the exemption method under Article 23 A, it is entitled to apply the credit method under Article 23 A, paragraph (2) with respect to items of income taxable under Article 10, 11, 12, 12 A or 12B.

16. The decision not to recommend a maximum rate of tax on income from automated digital services is consistent with Articles 10, 11, 12 and 12A of the United Nations Model Convention dealing with dividends, interest, royalties and fees for technical services, respectively. . The maximum rate of tax on fees for technical services is to be established through the bilateral negotiations of the Contracting States.

17. A precise level of withholding tax on payments in consideration of automated digital services, should take into account several factors, including the following:

- the possibility that a high rate of withholding tax imposed by a country might cause non-resident service providers to pass on the cost of the tax to customers in the country, which would mean that the country would increase its revenue at the expense of its own residents rather than the non-resident service providers;
- the possibility that a tax rate higher than the foreign tax credit limit in the residence country might deter investment;
- the possibility that some non-resident service providers may incur high costs in providing automated digital services, so that a high rate of withholding tax on the gross payment may result in an excessive effective tax rate on the net income derived from the services; and
- the relative flows of payments in consideration for automated digital services (e.g., from developing to developed countries).

18. The requirement of beneficial owner is included in paragraph 2 to clarify the meaning of the words "paid to a resident" as they are used in paragraph 1 of the Article. It clarifies that a Contracting State is not obliged to give up taxing rights over income from automated digital services merely because such income was paid directly to a resident of another State with which the first State had concluded a convention.

19. Since the term "beneficial owner" is included in paragraph 2 to address potential difficulties arising from the use of the words "paid to a resident" in paragraph 1, it is intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country. The term "beneficial owner" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries[1]), rather, it should be understood in its context, in particular in relation to the words "paid to a resident", and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

20. Relief or exemption in respect of an item of income is granted by a State to a resident of the other Contracting State to avoid in whole or in part the double taxation that would otherwise arise from the concurrent taxation of that income by the State of residence. Where an item of income is paid to a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for a State to grant relief or exemption merely on account of the status of the direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income qualifies as a resident but no potential double taxation arises as a consequence of that status, since the recipient is not treated as the owner of the income for tax purposes in the State of residence.

21. It would be equally inconsistent with the object and purpose of the Convention for a State to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the OECD's Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies"[2] concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal

[1] For example, where the trustees of a discretionary trust do not distribute income from automated digital services earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer) could constitute the beneficial owners of such income for the purposes of Article 12B even if they are not the beneficial owners under the relevant trust law.

[2] Reproduced at page R(6)-1 of Volume II of the full-length version of the OECD Model Tax Convention.

owner, it has as a practical matter very narrow powers which render it in relation to the income concerned a mere fiduciary or administrator acting on account of the interested parties.

22. In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the payments in consideration of automated digital services is not the "beneficial owner" because that recipient's right to use and enjoy the income is constrained by a contractual or legal obligation to pass on the income received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the income unconstrained by a contractual or legal obligation to pass on the income received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the payments by the direct recipient such as an obligation that is not dependent on the receipt of the income and which the direct recipient has as a debtor or as a party to financial transactions. Where the recipient of payments in consideration of automated digital services does have the right to use and enjoy the income unconstrained by a contractual or legal obligation to pass on the income received to another person, the recipient is the "beneficial owner" of such income.

23. The fact that the recipient of payments in consideration for automated digital services is considered to be the beneficial owner of such income does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision. As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company structures and, more generally, treaty shopping situations. These include specific anti-abuse provisions in domestic law and treaties, general anti-abuse rules in domestic law and tax treaties, judicial doctrines, such as substance-over-form or economic substance approaches, and the interpretation of tax treaty provisions. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on payments in consideration of automated digital services to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

24. The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments[3] that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e., individuals), cannot be reconciled with the express wording of Article 10, subparagraph 2(a), which refers to the situation where a company is the beneficial owner of a dividend. In the context of Articles 10, 11, 12, 12A and 12B, the term "beneficial owner" is intended to address difficulties arising from the use of the

[3] See, for example, Financial Action Task Force, International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation—The FATF Recommendations (OECD-FATF, Paris, 2012), which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner (at page 109): "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement." Similarly, the 2001 report of the OECD Steering Group on Corporate Governance, "Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes" (OECD, Paris, 2001), defines beneficial ownership as follows (at page 14): In this Report, "beneficial ownership" refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder.

words “paid to” in relation to dividends, interest, royalties, fees for technical services and income from automated digital services rather than difficulties related to the ownership of the underlying property or rights in respect of which the amounts are paid. For that reason, it would be inappropriate, in the context of these articles, to consider a meaning developed in order to refer to the individuals who exercise “ultimate effective control over a legal person or arrangement”.[4]

25. Subject to other conditions imposed by the Article, the limitation of tax in a State remains applicable when an intermediary, such as an agent or nominee located in the other Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State. The text of the United Nations Model Convention was amended in 2001 and 2017 (following amendments to the OECD Model Convention in 1995 and 2014) to clarify this point.

Paragraph 3

26. Paragraph 3 gives the beneficial owner of the income from automated digital services the option to be taxed on its qualified profits for a net basis annual taxation, as against the withholding mechanism provided for in paragraph 2. According to this paragraph, the beneficial owner of the income may request the Contracting State where the income arises to be subject to taxation on its qualified profits. This option would provide relief in those cases where the taxpayer may have a lower tax liability than the liability determined as per withholding tax mechanism as also in cases where it has a global business loss or a loss in the relevant business segment during the taxable year.

27 Paragraph 3 defines the qualified profits to be 30 percent of the amount arrived at by applying overall profitability of the beneficial owner or the profitability of its automated digital services segment, if the same is available to the gross annual revenue derived from the Contracting State where such income arises. If the beneficial owner belongs to a multinational group, the profitability ratio to be applied shall be that of such group, or of its automated digital services segment, if the same is available. The profitability ratio of the beneficial owner or the multinational group to which the beneficial owner belongs, is understood to be the total annual profits divided by the total annual revenue, as revealed by the consolidated financial statements of the beneficial owner or of the group it belongs, or of the automated digital services business segment, as the case may be. According to the international standards on transfer pricing[5], a multinational enterprise group is a group of associated enterprises with business establishments in two or more countries. Multinational groups of companies generally operate worldwide through locally incorporated subsidiaries or permanent establishments

28. The net income shall be taxable at the tax rate provided in domestic law of the Contracting State. The domestic law may also be having procedure for registration of such service providers as well as necessary forms to be filed for facilitating taxation of income from automated digital services on net income basis. Similarly, taxes withheld at source, if any as per paragraph 2, would be taken into account against the tax liability determined on net basis.

29. One member of the Committee considered that the profitability ratio could be reduced in situations where profits from some business segments are compensated by losses from other business segments. For this reason this member considers that paragraph 3 should be modified in order to introduce a mechanism where the beneficial owner’s qualified profits is the higher among: (i) the group’s overall profitability ratio (ii) the beneficial owner’s overall profitability ratio, and (iii) the beneficial owner’s profitability ratio of the automated digital services business segment.

[4] See the Financial Action Task Force’s definition quoted in the previous note.

[5] i.e.: Practical Manual on Transfer Pricing for Developing Countries, United Nations, New York, 2017 and OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, OECD, Paris 2017 .

Paragraph 4

30. Paragraph 4 defines “income from automated digital services” for purposes of Article 12B as payments in consideration for any service provided on the internet or an electronic network requiring minimal human involvement from the service provider.

31. A service is regarded as automated when the user is able to make use of service because of equipment and systems being in place, which allow the user to obtain the service automatically, as opposed to requiring a bespoke interaction with the supplier to provide the service. In determining whether a service requires minimal human involvement, the test only looks to the supplier of service, without regard to any human involvement on the side of the user. Furthermore, the definition focuses on provision of service and therefore does not include human interventions in creating or supporting or maintaining the system needed for provision of service. The threshold of minimal human intervention would not be crossed where the provision of service to new users involves very limited human response to individual user requests. An important indicator of concept of automated is whether there is ability to scale up and provide same type of service to new users with minimal human involvement. In other words, once the service offering of an automated digital business is developed (such as music catalogue or social media platform), then the business can provide that service to one user, or to many more, on an automated basis with the same basic business processes. On other hand, a non-automated digital business would see a proportionate increase in per unit costs in connection with providing the services to new customers.

32. The aspect of providing service over the internet or an electronic network distinguishes it from other service provision methods, such as the on-site physical performance of a service. No distinction is made between different internet, or electronic network transmission methods, to regard a service as automated digital service.

33. The definition of “income from automated digital services” in paragraph 4 is exhaustive; other payments for services are not included in the definition and are not dealt with in Article 12B. See the examples in paragraphs 34 and 36 below. If there are multiple supplies that are identifiable and substantive in their own right, then each individual supply is to be tested against the definition.

34. On the general principles above, the following services are considered to be automated digital services:

- Online advertising services;
- Online intermediation platform services;
- Social media services;
- Digital content services;
- Cloud computing services;
- Sale or other alienation of user data;
- Standardised online teaching services.

35. Online advertising services are understood as online services aimed at placing advertisement on a digital interface, including services for the purchase, storage and distribution of advertising messages, and for advertising monitoring and performance measurement. Online intermediation platform services and social media services involve a digital interface available to users for the purpose of enabling interaction between users, including for the sale, hire, advertisement, display or other offer by users of particular goods, services, user-generated content or other property to other users. Digital content services implies the automated provision of data in digital form, such as computer programs, applications, music, videos, texts, games and software, other than the data represented by a digital interface. Cloud computing services are those providing standardized on-demand network access to information technology resources. Sale or other alienation of data means the provision of data to a third party customer, where the data is generated by users of a digital interface, and is collected, compiled, aggregated or otherwise processed into data through an automated algorithm. For the purposes of this paragraph, “data generated by users” refers to all directly or indirectly identifiable personal data. Finally, standardised online teaching services are those involving the provision of an online education programme provided to an unlimited number

of users, which does not require: (i) the live presence of an instructor; or (ii) significant customisation on behalf of an instructor to a particular user or limited group of users, whether with respect to the curriculum, teaching materials, or feedback provided.

36. On the general principles in paragraphs 29 to 31 above, the expression "income from automated digital services" does not include:

- Customised services provided by professionals;
- Customised online teaching services;
- Services providing access to the Internet or to an electronic network;
- Online sale of goods and services other than automated digital services;
- Broadcasted services including simultaneous internet transmission;
- Composite digital services embedded within a physical good irrespective of network connectivity ("internet of things").

37. The expression "Customised services provided by a professional" includes services whether individually or as a firm, such as those provided by a lawyer, accountant, bookkeeper, architect, engineer, medical professional or financial or other specialised expert consultant. Customised online teaching services mean live or recorded teaching services delivered online, where the teacher customises the service (such as by providing individualised, non-automated feedback and support) to the needs of a student or a limited group of students and the Internet or electronic network is used as a tool simply for communication between the teacher the student.

38. It may be clarified that services providing access to the Internet or to an electronic network are out of the scope of Article 12B; the provision of access (i.e. connection, subscription, installation) to the Internet or to an electronic network irrespective of the delivery method, namely over wire, lines, cable, fibre optics, satellite transmission or other means, typically requires a degree of local infrastructure and is subject to local telecommunication regulations.

39. By "online sale of goods and services other than automated digital services" is intended to refer to the sale of a good or service completed through a digital interface where: (i) the digital interface is operated by the provider of the good or service; (ii) the main substance of the transaction is the provision of the good or service; and (iii) the good or service does not otherwise qualify as an automated digital service. Broadcasted services including simultaneous internet transmission are understood as services that are simultaneously provided via broadcast to the general public over communication networks other than the Internet or electronic networks. The expression "Composite digital services embedded within a physical good ("internet of things")" applies irrespective of the network connectivity of that physical good, provided that there is no separately identifiable automated digital service revenue stream attached to that physical good.

40. There may be a situation where particular kind of automated digital services may fall under scope of technical services covered by Article 12A wholly or partly. Provisions of Article 12A would apply where such services are wholly overlapping with scope of Article 12A. This is clarified through second sentence of paragraph 4. Where, however, part of services amongst bundle of automated digital services are falling within scope of technical services, taxation of such part only would be governed by Article 12A and for the remaining, Article 12B would apply.

41. It should be noted that, while Article 12A excludes payments by individuals for services for personal use from the definition of "fees for technical services", paragraph 4 of Article 12B does not make a similar exclusion. In consequence, Article 12B also applies to automated digital services provided to individuals for their personal use. Even though such payments would not normally be deductible by those individuals for tax purposes, it cannot be disregarded that many multinational enterprises that rely on digital business models derive a very significant portion of income from the provision of automated digital services generally to individual consumers. Since, the imposition of withholding tax obligations on such payments by individuals under domestic law would be difficult to enforce and might cause compliance problems for individuals consuming automated digital services supplied remotely by non-residents, other mechanisms for collection may be required.

42. In this sense, domestic legislation in some jurisdictions levying taxes on automated digital services requires non-resident providers to present a tax return where the tax obligation has been self-assessed and subject to examination by the tax administration. Other jurisdictions, instead, have the obligation to determine and pay the tax due by the non-resident provider, to the financial intermediary that individual consumers access to make the payments for the automated digital services involved.

43. Although paragraph 4 defines the phrase “income from automated digital services,” it does not provide a definition of the term “services.” Similarly, other articles of the United Nations Model Convention dealing with various types of services do not contain any definition of the term “services.” Neither Article 12A which deals with fees for technical services, Article 14, which deals with professional and other independent personal services, nor Article 19, which deals with services rendered to the government of a Contracting State, provide a definition of the term “services.” Similarly, the General Agreement on Trade in Services does not contain any definition of the term “services.”

44. Although the term “services” in the phrase “income form automated digital services” is undefined in the context of Article 12B, the term “services” should be understood to have a broad meaning in accordance with ordinary usage to generally include activities carried on by one person for the benefit of another person in consideration for a fee. Such activities can be carried out in a wide variety of ways and the manner in which such services are provided does not alter their character for the purpose of Article 12B, to the extent that such services fall within the definition of “automated digital services” in paragraph 4.

45 It is often necessary to distinguish between payments in consideration for services, including those for automated digital services, and royalties in order to determine whether Article 12 or another Article of the Convention (Article 12B in the case of “income from automated digital services”) is applicable. The distinction between payments for consideration of services and royalties is clear in principle. Under Article 12, paragraph 3, royalties are payments for the use, or the right to use, certain types of property or information concerning industrial, commercial or scientific experience (so-called know-how). In contrast, the performance of services does not involve any transfer of the use of, or the right to use, property. However, in practice it is often difficult to distinguish between royalties and fees for services, including automated digital services, especially with respect to so-called mixed contracts. Guidance with respect to the distinction between fees for services and royalties is provided in paragraph 12 of the Commentary on Article 12 of the United Nations Model Convention, which reproduces paragraphs 11.2–11.6 of the Commentary on Article 12 of the OECD Model Convention.

Paragraph 5

46. This paragraph provides that paragraphs 1, 2 and 3 do not apply to income from automated digital services if the person who provides the services has a permanent establishment or fixed base in the State in which the income arises and the income is effectively connected with that permanent establishment or fixed base. In this regard, paragraph 5 is similar to Article 10, paragraph 4, Article 11, paragraph 4, Article 12, paragraph 4, and Article 12A, paragraph 4. Thus, if a resident of one Contracting State provides automated digital services through a permanent establishment or fixed base located in the other Contracting State, the payment received for those services will be taxable by the State in which the permanent establishment or fixed base is located in accordance with Article 7 or Article 14, rather than in accordance with Article 12B.

47. Since Article 7 of the United Nations Model Convention adopts a limited force-of-attraction rule, which expands the range of income that may be taxed as business profits, paragraph 5 also makes paragraphs 1, 2 and 3 inapplicable if the income from automated digital services are effectively connected with business activities in the State in which the income arise that are of the same or similar kind as those effected through the permanent establishment.

48. The paragraph does not define the meaning of the expression “effectively connected.” As a result, whether income from automated digital services are effectively connected with a permanent establishment, fixed base or business activities similar to those carried on through a permanent establishment must be determined on the basis of all the relevant facts and circumstances of each case. In general, income from automated digital services would be considered to be effectively connected with a permanent establishment or fixed base if the automated digital services are closely related to or connected with the permanent establishment or fixed base or if the business activities are similar to those carried out through the permanent establishment. This will be the case where the remuneration paid to the person providing the services is borne by the permanent establishment or fixed base in the State in which the income arise.

49. Where paragraph 5 applies, payments for consideration of automated digital services are taxable by the State in which the income arise as part of the profits attributable to the permanent establishment in accordance with Article 7 or the income attributable to the fixed base in accordance with Article 14. Thus, paragraph 5 relieves the State in which the income from automated digital services arise from the limitations on its taxing rights imposed by Article 12B. Where Article 7 applies as a result of the application of paragraph 5, most countries consider that the State in which the permanent establishment is located is allowed to tax only the net profits from the automated digital services attributable to the permanent establishment. Article 7 does not preclude taxation of business profits attributable to a permanent establishment on a gross basis, but a Contracting State must not discriminate against residents of the other State in violation of paragraph 3 of Article 24 (Non-discrimination). Similarly, where Article 14 applies, most countries consider that the State in which the fixed base is located is allowed to tax only the net income derived from the automated digital services.

Paragraphs 6 and 7

50 Paragraph 6 lays down the principle that the State in which income form automated digital services arise for purposes of Article 12B is the State of which the payer of the income is a resident or the State in which the payer has a permanent establishment or fixed base if the payments for the automated digital services are borne by the permanent establishment or fixed base. It is not necessary for the services to be provided in the Contracting State in which the payer is resident or has a permanent establishment or fixed base. Whether a person is a resident of a Contracting State for purposes of Article 12B is determined in accordance with the provisions of Article 4 of the Convention.

51. Where there is an obvious economic link between automated digital services being provided and the permanent establishment or fixed base of the payer to which the services are provided, the income from automated digital services are considered to arise in the State in which the permanent establishment or fixed base is situated. This result applies irrespective of the residence of the owner of the permanent establishment or fixed base, even where the owner resides in a third State.

52. Where there is no economic link between the automated digital services and the permanent establishment or fixed base, the payments for automated digital services are considered to arise in the Contracting State in which the payer is resident. If the payer of fees for automated digital services is not a resident of a Contracting State, Article 12B does not apply to the income from automated digital services unless the payer has a permanent establishment or fixed base in the Contracting State and there is a clear economic link between the automated digital services and the permanent establishment or fixed base. Otherwise there would be, in effect, a force-of-attraction principle for payments in consideration for automated digital services, which would be inconsistent with other provisions of the United Nations Model Convention.

53. Paragraph 6 is subject to paragraph 7, which provides an exception to the source rule in paragraph 6. Paragraph 7 deems payments in consideration for automated digital services made by a resident of a Contracting State not to arise in that State where that resident (the payer) carries on business through a permanent establishment in the other Contracting State or performs independent personal services through a fixed base in the other Contracting State or in a third State and the payments for automated digital services are borne by that permanent establishment

or fixed base. As a result, in these circumstances, the Contracting State in which the payer is resident is not allowed to tax the payments for automated digital services under paragraph 2 or 3.

54. The phrase “borne by” must be interpreted in the light of the underlying purpose of paragraphs 6 and 7, which is to provide source rules for income from automated digital services. A Contracting State is entitled to tax income from automated digital services under paragraph 2 or 3 only if the income arises in that State. The basic source rule in paragraph 6 is that income from automated digital services arise in a Contracting State if the payer is a resident of that State or the payer has a permanent establishment or fixed base in a Contracting State and the payments in consideration for automated digital services are borne by that permanent establishment or fixed base. However, the basic rule is limited by the deeming rule in paragraph 7 where the payer is a resident of a Contracting State but the payments in consideration for automated digital services are borne by a permanent establishment or fixed base that the payer has in the other Contracting State.

55. Where payments in consideration for automated digital services are incurred for the purpose of a business carried on through a permanent establishment or for the purpose of independent personal services performed through a fixed base, those payments will usually qualify for deduction in computing the profits attributable to the permanent establishment under Article 7 or the income attributable to the fixed base under Article 14.

56. The fact that the payer has, or has not, actually claimed a deduction for the payments for automated digital services in computing the profits of the permanent establishment or the income of the fixed base is not necessarily conclusive, since the proper test is whether any deduction available for those payments should be taken into account in determining the profits attributable to the permanent establishment or the income attributable to the fixed base. For example, that test would be met even if no amount were actually deducted as a result of the permanent establishment or fixed base being exempt from tax or as a result of the payer simply deciding not to claim a deduction to which it was entitled. The test would also be met where the payments for automated digital services are not deductible for some reason other than the fact that such expenses should not be allocated to the permanent establishment or fixed base.

Paragraph 8

57. The purpose of paragraph 8 is to restrict the operation of the provisions concerning the taxation of income from automated digital services in cases where, by reason of a special relationship between the payer and the beneficial owner of the income or between both of them and some other person, the amount of the payments paid exceeds the amount that would have been agreed upon by the payer and the beneficial owner if they had stipulated at arm’s length. Paragraph 8 provides that in such a case the provisions of the Article apply only to the last-mentioned amount and the excess part of the payments for automated digital services would remain taxable according to the laws of the two Contracting States, due regard being had to the other provisions of the Convention.

58. It is clear from the text that in order for this paragraph to apply the payments in consideration for automated digital services held to be excessive must be due to a special relationship between the payer and the beneficial owner of the income or between both of them and some other person. There may be cited as examples of such a special relationship cases where remunerations for automated digital services are paid to an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by the individual or is subordinate to a group having common interest with the individual. These examples, moreover, are similar or analogous to the cases contemplated by Article 9.

59. On the other hand, the concept of special relationship also covers relationship by blood or marriage and, in general, any community of interests as distinct from the legal relationships giving rise to the payment in consideration for the automated digital services.

60. With regard to the taxation treatment to be applied to the excess part of the payments for technical services, the exact nature of such excess will need to be ascertained according to the circumstances of each case, in order to determine the category of income into which it should be

classified for the purposes of applying the provisions of the tax laws of the States concerned and the provisions of the Convention. Unlike Article 11, paragraph 6, which, because of the limiting phrase “having regard to the debt-claim for which it is paid,” permits only the adjustment of the rate at which interest is charged, paragraph 8 permits the reclassification of the remuneration for automated digital services in such a way as to give them a different character. This paragraph can affect not only the recipient of the payments, but also the payer of excessive remuneration for automated digital services; if the law of the State where the payer is resident or has a permanent establishment or a fixed base permits, the excess amount can be disallowed as a deduction, due regard being had to other applicable provisions of the Convention. If two Contracting States have difficulty in determining the other provisions of the Convention applicable, as cases require, to the excess part of the remuneration for automated digital services, there would be nothing to prevent them from introducing additional clarifications in the last sentence of paragraph 8, as long as they do not alter its general purport.

61. Where the principles and rules of their respective laws oblige the two Contracting States to apply different Articles of the Convention for the purpose of taxing the excess part of payments in consideration for automated digital services, it will be necessary to resort to the mutual agreement procedure provided by the Convention in order to resolve the difficulty.