

**Characterisation of
E-Commerce Transactions:
A Review of TAG Final Report
on Tax Treaty Characterisation**

NOVEMBER 2001

RAYMOND YU

ABSTRACT

Different tax consequences flow from the characterisation of a transaction, from the determination of taxing rights to whether withholding tax is payable in respect of the payment. E-commerce presents a new context in which characterisation issues need to be addressed. The Technical Advisory Group (TAG), which was formed by the OECD, have discussed such issues for two years and have now released its final report. This paper, in reviewing this report from an Australian perspective, have reached the conclusion that the approach adopted by the TAG is broadly consistent with Australian jurisprudence and practice in respect of tax treaty characterisation. The dynamic and evolving nature of e-commerce means that application issues remain, uncertainties continue to exist, and so will opportunities for structuring. In this regard, even though the TAG report may not be binding to a court of law in Australia, it, at the very least, is useful in providing a common, and internationally accepted, framework to address characterisation issues.

TABLE OF CONTENTS

INTRODUCTION	1
BACKGROUND	2
CHARACTERISATION: GENERAL ROLE	2
CHALLENGES POSED BY E-COMMERCE	4
OECD AND TAG	5
DISTINCTIONS OF INTEREST	6
BUSINESS PROFIT VERSUS PAYMENTS FOR USE OF, OR RIGHT TO USE, A COPYRIGHT	8
ISSUES	8
TAG CONCLUSION	9
COMPARISON WITH OECD COMMENTARY	11
ROYALTY IN AUSTRALIA	12
<i>Definition</i>	12
<i>Use of or Right to Use a Copyright</i>	14
<i>Synergies with Copyright Law</i>	17
<i>Extended Definition of Royalty in Australia</i>	18
SUMMARY AND COMMENTS	19
BUSINESS PROFIT VERSUS PAYMENT FOR KNOW-HOW	20
SYNERGIES WITH AUSTRALIAN LAW	23
PAYMENT FOR THE USE OF INDUSTRIAL, COMMERCIAL AND SCIENTIFIC EQUIPMENT	23
LIMITED DURATION SOFTWARE IN AUSTRALIA	25
TECHNICAL FEES	26
SERVICES VERSUS PROPERTY TRANSACTIONS	27
<i>Computer Equipment</i>	28
<i>Intangibles And Other Non-Computer Hardware Products</i>	29
TREATMENT OF MIXED PAYMENTS	30
IS BIFURCATION REQUIRED IN AUSTRALIA?	31
PRACTICAL MATTERS	32
NON-EXTREME CASES	32
DOUBLE TAXATION OR PLANNING OPPORTUNITIES?	34
LEGAL STATUS OF THE TAG RECOMMENDATIONS	36

Characterisation of E-Commerce Transactions

CONCLUSION 37

BIBLIOGRAPHY 39

APPENDIX 1: SUMMARY OF OECD FINAL REPORT'S 28 CATEGORIES OF E-COMMERCE TRANSACTIONS I

INTRODUCTION

Estimate of the growth of electronic commerce (“e-commerce”) varies, but the consistent message is that e-commerce transactions are exploding. OECD predicts that total e-commerce transactions may reach as much as \$US1 trillion by 2003-2005.¹ E-commerce represents a completely new frontier: transactions are conducted through non-physical means and business models are still evolving.²

The threats and challenges that e-commerce pose to taxation have not gone unnoticed to governments and economic organisations around the world.³ The Organisation for Economic Co-operation and Development (“OECD”) and the Australian Taxation Office (“ATO”) have begun to explore e-commerce related tax issues in 1996. The general thrust of the ATO’s current approach to e-commerce, not that there is any specific policy,⁴ is not to rely on unilateral rules, but to foster international consensus and co-operation.⁵ The nature of the new medium is such that in the absence of an international approach, cross-border e-commerce transactions may be exposed to double taxation or no taxation at all, and harmful tax practice and competition may arise.⁶

It is therefore interesting to review the international development in the taxation of e-commerce as this may shed light upon the direction of e-commerce taxation in Australia. This paper examines the final report released by the Technical Advisory Group (“TAG”) on the issue of characterisation of e-commerce transactions in the

¹ OECD “The Economic and Social Impact of Electronic Commerce: Preliminary Findings and Research Agenda” (1999) <http://www1.oecd.org/subject/e_commerce/ebooks/027-054.pdf>.

² Scott, D. “E-Commerce”, 4th Annual Victorian State Convention, 30 August 2001, Taxation Institute of Australia. For some recent examples of business model see Rice, V. “E-Business Lessons From Luxury” <<http://www.zdnet.com.au/newstech/ebusiness/story/0,2000024981,20222166,00.htm>>

³ The governments of Australia, United States, Canada, New Zealand and United Kingdom have all produces extensive reports into taxation and the internet. See ATO, Discussion Report of the Australian Taxation Office Electronic Commerce Project Team, “Tax and the Internet”, August 1997 (“the First Report”); ATO, Second Report of the Australian Taxation Office Electronic Commerce Project Team, “Tax and the Internet”, December 1999 (“the Second Report”); Revenue Canada, Electronic Commerce and Canada’s Tax Administration, April 1998; United Kingdom’s Inland Revenue and HM Customs and Excise, Electronic Commerce: UK Taxation Policy, October 1998.

⁴ Since the release of the Second Internet Report in 1999, they have been silent on this issue.

⁵ See the First Report and the Second Report.

⁶ De Zilva, A. ‘Tax and E-Commerce’ in International Tax Masterclass- New South Wales Division, Taxation Institute of Australia, 31 August 2000.

treaty context (the “Final Report”).⁷ Given that the ATO is closely involved with this TAG, it is likely that principles adopted in this recommendation would closely reflect ATO’s thinking and policies in this area.

This paper in the next section first sets the scene for subsequent discussion by stating the role of characterisation and outlining the history of the TAG’s activities in respect of this issue. Subsequent sections of this paper canvass the Final Report’s conclusion in respect of royalty, know-how, services and property transaction, technical fee clause, mixed payment, use of industrial, commercial or scientific equipment. During the discussion the TAG’s classification of the 28 categories are examined. The TAG’s recommendations are compared against current Australian approach to tax treaty characterisation to identify similarities and differences. The final section considers the practical dimension of these characterisation rules.

BACKGROUND

To put this paper in its proper context, characterisation in the overall scheme of taxation, particularly international taxation, is first presented. This section also provides a snapshot of the works done by the TAG in this respect.

Characterisation: General Role

Characterisation is a fundamental threshold issue in taxation, both domestic and international, as it impacts upon the tax consequences that flow from the transactions.⁸ Under the current model of international taxation, especially involving treaties jurisdictions, characterisation of income is fundamental to the determination of taxing rights: it identifies what income the source State can tax in the hands of a non-resident.

⁷ OECD Report of the Technical Advisory Group to Working Party No.1 of the OECD Committee on Fiscal Affairs, “Tax Treaty Characterisation Issues Arising for E-commerce”, 1 February 2001.

⁸ It is interesting to note that whilst there is a concerted push, especially on the part of the US, towards residence based taxation in light of e-commerce, which would eliminate much of the characterisation issues noted herein, there seems little possibility that such a shift in approach is forthcoming any time soon, if ever. See US Government Report “Selected Tax Policy Implication of Global Electronic commerce” (1996) <<http://www.treas.gov/taxpolicy/internet.html>>.

Depending on how the transaction is characterised, the rights and extent to which a country can tax the payment varies. Different forms of income are taxed differently under domestic rules of each country and under international tax treaties. Some possibilities include:

- Payment characterised as a royalty. The payment is taxed on a gross basis by imposing withholding tax at source. In Australia, the withholding rate is 30% where no tax treaty applies, or, 10% in most cases where tax treaty applies.⁹ The withholding tax would also represent a final tax liability.¹⁰
- Income from the provision of goods or services. The payment is usually taxed on a net basis, but only if the business has a permanent establishment in the jurisdiction, and only to the extent the services are attributable to that permanent establishment.¹¹ In the absence of a permanent establishment, the payment would be exempted from source country tax.
- Assessable as a capital gain. The payment would either be taxed concessionally or exempt from tax as the asset may lack connection with the jurisdiction.¹² This consequence seems unlikely in the context of e-commerce transactions, but is noted here for completeness.

At a more specific level, characterisation is directly relevant to the operation of the source rules. A country can typically only tax the income of non-resident where the income is sourced in that country. Because source rules vary depending on the type of income, characterisation is of fundamental importance. In respect of e-commerce transactions, there are two broad alternatives: (i) royalty, and (ii) payment for services. If the payment is regarded as a royalty, then the source is generally taken to be where the owner of the rights is located. If it is treated as a services income, then

⁹ Royalty withholding rate between Australia and United States have recently been changed to 5% (effective on or after 1 July 2003). Refer to Protocol Amending The Convention Between The Government Of Australia And The Government Of The United States Of America For The Avoidance Of Double Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income, available at <http://www.ato.gov.au/content.asp?doc=/content/Businesses/15715.htm>

¹⁰ See generally ITAA 1936, Part III, Div 11A.

¹¹ Ie. For jurisdictions adopting Article 7 of OECD Model Tax Convention.

¹² In Australia, refer to ITAA 1997 Pt 3-1, Div 136.

the source would generally be the place of performance. Of course, in the case of Australia, these are but rule of thumbs, as the real test relies on an analysis of the facts and circumstances.¹³

In summary, characterisation determines the appropriate tax rules that is to apply to the transactions – affecting issues like source of income, withholding obligations, whether the income is taxable under the tax treaty.

Challenges Posed By E-Commerce

Characterisation of income is never easy. In fact, it has been pointed out that “[t]here is no practicable way of distinguishing between different types of income under an income tax”.¹⁴ E-Commerce accentuates this difficulty as it is so new; and the fact that the technological basis and business models underpinning the transactions are still evolving make it worst. The difficulties are not so much with conducting traditional transaction, such as sale of tangible goods, online; but with the electronic transmission of digitised information like software programs, text, sound or video images.¹⁵ The variety and hybrid nature of digital products and modes of delivery make the tax classification of payments for such transactions particularly difficult.¹⁶

The characterisation issue is the same, but the transactions are set in a very novel context. Take for example, an Australian magazine publisher that sells magazines on the Internet. A customer pays a fee and may be entitled to view, download or print the content. The sale of magazines in hard copy format would be assessable income of the magazine publisher in Australia. By moving the business to the digital world, the following taxation consequences may arise:

¹³ Refer to cases like *Nathan v FCT* (1918) 25 CLR 183; *FCT v Mitchum* (1965) 113 CLR 401.

¹⁴ This point can be traced back to the insightful comments of the four economists who formulated the recommendation to address double taxation in the League of Nation days. See Tillinghasat, D. “Are Tax Treaties Necessary” (1999) 53 Tax L. Rev. 1.

¹⁵ Reid, T. ‘Tax characterization on Electronic Commerce Revenue’ (2000) 1 E-Commerce Tax Report 197.

¹⁶ Andrews, W. “A Platform for International E-Commerce Tax Rules- Part 2: What Should the New Rules Look Like?” (2001) 12 J. of Int. Tax. 10.

- By viewing the online magazine, the customer creates a temporary electronic copy of the magazine but does not acquire any goods or any right to use the material. The income could then be regarded as derived from the provision of a service;
- Downloading the magazine (to the customer's hard disk for future printing or duplication) may constitute either the provision of a good or a right to reproduce the material. As a result, the fee income could be sales income subject to tax at source where there is a permanent establishment, or, royalty income subject to withholding tax, or, a combination of both.

This highlights the possibilities in characterisation that may arise in respect of transactions involving the new digital medium. Transactions can be structured to avoid being characterised as royalties and fall instead within the business profits articles of bilateral tax treaty. The transaction may then avoid Australian tax to the extent that Internet allows significant activities to be undertaken by non-residents without a permanent establishment being deemed to exist.¹⁷ Further, given that the tax consequence varies depending on the category of income, then to the extent that there are inconsistent characterisation between domestic law and tax treaty, double taxation could arise.¹⁸

OECD and TAG

The OECD has recognised the importance of the taxation issues posed by e-commerce, and has been addressing these issues for many years. Starting in Turku, Finland in November 1997, the OECE initial assessment is that existing domestic and international tax systems could cope with the new e-commerce transactions.¹⁹ This is followed by the Ottawa Ministerial Conference in October 1998, which led to the formation of the five TAGs by the OECD Committee on Fiscal Affairs in January 1999. Each TAG is responsible for studying the tax issues arising from a specific

¹⁷ Note that, based on recent amendment to the OECD Commentary, a server on which a web site is stored and used may constitute a permanent establishment of the enterprise that operates the server. See OECD Committee on Fiscal Affairs, "Clarification on the Application of the Permanent Establishment Definition in E-Commerce: Changes to the Commentary on the Model Tax Convention on Article 5", 22 December 2000.

¹⁸ See Doernberg, R. and Hinnekens, L. *Electronic Commerce And International Taxation* (1999), Kluwer Law International, The Hague, Netherland., p20.

¹⁹ See proceeding materials at <http://www.oecd.org/dsti/sti/it/ec/>.

aspect of e-commerce with the aim of developing a globally acceptable approach.²⁰ The composition of each TAG reflects the desire to pool input and opinions from diverse sources: each group is comprised of participants from both government and the business community, and include nations from prominent OECD member states, as well as non-OECD states that are often less economically developed.

One of the issues being studied is characterisation. Countries involve in this TAG are Australia, Germany, Japan, Norway, the United Kingdom, and the United States, together with non-OECD nations Chile, Israel, the Philippines, and the host nation, India. The private sector participants included IBM, Baker & McKenzie, Siemens, NTT Data, Softec, and Walt Disney Corporation.²¹

Following a series of initial meetings in 1999, the Treaty Characterisation TAG issued a document on 24 March 2000, which identified 26 distinct e-commerce transactions and described the group's preliminary views on how each type of payment should be categorised for income tax purposes under the OECD Model Tax Convention. Public feedback was invited and many were in fact received. All these feedback were considered at a TAG meeting held during July 2000 in Paris. After further discussion, a revised report containing their general conclusions were prepared and issued on 1 September 2000 during the International Fiscal Association's 2000 World Congress in Munich. The list of e-commerce transactions considered in the report increased to 27 distinct scenarios.

The TAG issued the final recommendations on the characterisation of e-commerce transactions in February 2001. If adopted by the OECD, the recommendations in the report will become part of the Commentaries used to interpret the OECD Model Tax Convention.

Distinctions of Interest

A most controversial issue in the characterisation of e-commerce payments is the distinction between Article 7 business profit and Article 12 royalties of the OECD

²⁰ See the Final Report, Annex 3, for specific mandate of the TAG.

²¹ Refer to the Final Report, Annex 3.

Model Tax Convention.²² Not surprisingly, this key distinction is the one that the TAG report focuses upon in its discussion. In addition to this overarching distinction, the Final Report also canvasses a few other distinctions. As a subset of business profit, a distinction can be made between services and non-services (property) transactions. Although under Article 7 different sub-categories of business profits, like services, non-services, rentals, etc, are not often distinguished, they could have significance in respect of individual tax treaty or under the domestic tax law of a country.

In relation to royalty, it is usually referred to as payment for the use of, or the right to use, a copyright. However, depending on the bilateral treaties in question, the following could also give rise to a royalty payment:

- Know-how; or
- Payment for the use of, or the right to use, industrial, commercial or scientific equipment.

Another category that is often found in tax treaty is so called “technical fee” clauses. Such clauses typically give the source country taxing rights over payment that is regarded as a technical fee.

The subsequent discussion examines these distinctions, namely:

- Business profit and payment for the use of, or right to use, a copyright;
- Business profit and know-how;
- Business profit and payment for the use of, or the right to use, industrial, commercial or scientific equipment;
- Services and property transactions;
- Business profit and technical fees.

²² References to “Article” herein are to the OECD Model Tax Convention, unless stated otherwise.

The classification of the Final Report in respect of the 28 categories are summarised in Appendix 1.²³

BUSINESS PROFIT VERSUS PAYMENTS FOR USE OF, OR RIGHT TO USE, A COPYRIGHT

A most significant e-commerce characterisation issue is the distinction between Article 7 business profit and Article 12 royalty because, as noted above, different tax consequences may arise.

Royalties for this purpose is defined under Article 12 of the OECD Model Tax Convention in the following terms:

“The term “royalties” as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.”

Issues

In short, royalty is a payment for the use of, or the right to use, a copyright. It is thus not surprising that some considered that the existence of a royalty payment hinges on copyright law. The debate revolves around a contest between a strict copyright law approach and, what may be referred to as, a pragmatic approach. Under the strict approach, the process of downloading computer programs or some other digital contents, may itself, depending on the copyright law of the country, constitutes using one of the rights protected by copyright, and hence result in a payment for the “use of a copyright”. After all, the transaction would involve a contract that grants the end-user the right to make one or more copies of the digital content. For instance, when

²³ Note that apart from the broad distinction between business profit and royalty, the Final Report did not explicitly ruled upon the other distinctions noted above in all categories. In this regard, the table is constructed on the basis of the conclusion in the Final Report, as well as logical inference in situation where the conclusion is unclear.

the user downloads data onto a non-temporary media, such as the hard drive of a computer, the user could be exercising a right granted by the vendor that is protected under copyright law. Consequently, the payment is in respect of the use of, or the right to use, the copyright that subsists in the digital content.

This line of argument is adopted by a minority of the TAG before the Final Report. Following this logic, impractical, and even absurd, conclusion may arise. The act of “copying” is inevitably involved with digital transactions. Digital copies of the products, which can be software program or music, are made throughout the process of transferring the product from the originating server to the end-user’s computer. The retaining of a copy of the digital instructions representing the software in the computer’s RAM could itself amounts to the use of the copyrighted material. Under a strict approach, royalty would arise in respect of each of these steps in the transaction!

The majority adopted the pragmatic line that the act of permission to create a copy is merely incidental to the broader purpose of the transactions, being the acquisition of a copyrighted article. Unlike the minority, the majority see through the “incidental right” and consider it as no more than an artefact of the electronic mode of delivery.

TAG Conclusion

In the Final Report, whilst noting that most digital transactions often do not result in royalties, the TAG has agreed upon a unified approach that focuses on the “essential consideration”. The question to ask is: what is the main purpose of the “essential consideration”?²⁴ The test does not involve a formal copyright law based analysis of the digital transactions; instead, the economic substance of the transaction is of paramount significance. The deciding factor becomes whether the consideration is for the right to download and use the product, or, for the product itself. In this regard, according to the Final Report the use of copyright should be disregarded in determining the character of the payment for treaty purposes where:²⁵

²⁴ Paragraph 14 of the Final Report.

²⁵ Paragraph 14 of the Final Report.

- The essential consideration is for something other than the use of, or right to use, rights in the copyright (such as to acquire other types of contractual rights, data or services); and
- The use of copyright is limited to the rights required to enable downloading, storage and operation on the customer's computer, network or other storage, performance or display device.

This is best illustrated by way of an example. Suppose a customer buys and downloads computer software online, similar to Categories 2 and 28.²⁶ Here, a copy of the software file is made and then transmitted electronically to the customer, and a copy of the software saved on the person's hard drive. Whilst this act of copying of the software may technically constitute the use or exercise of a copyright (depending on the country's copyright law), the substance of the transaction is one of purchase of software. That is, the essential consideration is not to exercise copyright rights through the activity of downloading, but to obtain the data transmitted in the form a digital signals.

In relation to the download of computer software, it is unanimously agreed that the essential consideration is for the right to use the computer program on the user's computer or network, rather than for the ability to exercise copyright rights. Any act of copying of the software onto non-temporary media that may otherwise involve a reproduction of copyrighted material under copyright law is disregarded as being merely an incidental part of the transaction.²⁷ This view reflects the commercial reality that money is paid to purchase the product rather than for the right to use the copyright.

In relation to the download of other digital products, the consensus is less coherent. In the Final Report, all representatives agree that the download of digital product "for personal use" constitutes business profit rather than royalty.²⁸ This covers action such

²⁶ Reference to "category" refers to the Category of transaction examines by the TAG in the Final Report.

²⁷ Schickli, W. "Characterization of E-Commerce Revenue- The Final OECD Report Revealed" (2001) 22 Tax Notes Int. 1671.

²⁸ Paragraph 15 of the Final Report.

as downloading of software, text, pictures or music off the Internet. In downloading a digital product in this context, it was agreed that the payment is for “acquiring data transmitted in the form of a digital signal for the own use or enjoyment of the acquirer”, such that the essential consideration for the payment is the right to receive the digital product (i.e. data) rather than the right to use the product in the sense of downloading it to non-temporary media.

Comparison with OECD Commentary

The current edition of the OECD Commentary on Article 12, incorporating the revision made in year 2000, provides that “[t]he character of payments received in transactions involving the transfer of computer software depends on the nature of the rights that the transferee acquires under the particular arrangement regarding the use and exploitation of the program.”²⁹ Although this seems to focus on the technical aspect of copyright law, especially when compared to the 1992 wordings,³⁰ on closer examination the Commentary also looks at the economic substance of software transactions. In this regard, the Commentary went on to provide certain exclusions:

- Payment made in exchange for the granting of rights that are limited to those necessary to operate copyrighted program should not be treated as royalty, regardless whether the rights are granted under the law or under a licence agreement with the copyright owner.³¹
- The method of transferring a computer program is irrelevant to the characterisation of the income from the transaction.³²
- The granting of the right to make copies for internal distribution under a site licence or enterprise licence should not cause the income from such a licence to be treated as royalty.³³

²⁹ 2000 Commentary on Article 12 of the OECD Model Tax Convention, at paragraph 12.2.

³⁰ See Sprague, G. and Schindler, O. “Another Step Towards Uniformity- relative Consensus of the OECD TAG on Income Characterization of E-Commerce Transactions” [2001] *Tax Management Int. J.* 267.

³¹ Commentary on Article 12 of the OECD Model Tax Convention, at paragraph 14.

³² Id at paragraph 14.1

³³ Id at paragraph 14.2.

In summary, the Final Report's position is consistent with the OECD revised Commentary on Article 12.³⁴

Royalty in Australia

Definition

The term "royalty" is defined under sub-section 6(1) of the *Income Tax Assessment Act 1936*. It is defined to include any amount paid or credited, however described or computed, and whether the payment or credit is periodical or not, to the extent that it is paid or credited as consideration for:

- (a) the use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trademark, or other like property or right.
- (b) the use of, or the right to use, any industrial, commercial or scientific equipment.
- (c) the supply of scientific, technical, industrial or commercial knowledge or information;
- (d) the supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property or right referred to in para (a), any such equipment referred to in para (b), or any such knowledge or information referred to in para (c);
- (da) the reception of, or the right to receive, visual images and/or sounds transmitted to the public by satellite, cable, optic fibre or similar technology (only applicable to amounts derived during the 1993/94 or a later income year);
- (db) the use of, or the right to use, visual images and/or sounds in connection with television or radio broadcasting which are transmitted by satellite, cable, optic

³⁴ Goulder, R. 'OECD Treaty Characterization TAG Finds Consensus on E-Commerce Tax Issues' (2000) 21 Tax Notes Int. 2335.

- fibre or similar technology (only applicable to amounts derived during the 1993/94 or a later income year);
- (dc) the use of, or the right to use, spectrum specified in a spectrum licence issued under the *Radio Communications Act 1999*;
- (e) the use of, or the right to use, motion picture films, films or video tapes for use in connection with television, or tapes for use in connection with radio broadcasting; or
- (f) a total or partial forbearance in respect of the use of, or the right to use, property of any of the kinds referred to in para (a), (b) or (e) above, the supply of knowledge, information or assistance as referred to in para (c) or (d) above, the reception or right to receive visual images or sounds as referred to in para (da) or (db) above, or a dealing with some or all of the spectrum specified in a spectrum licence as referred to in para (dc) above.

This is an inclusive definition, so royalties in Australia would also covers items that are within the ordinary meaning of that term. The ordinary meaning of “royalty” has been well established by the Courts in cases like *Stanton v FCT*³⁵, *McCauley v FCT*³⁶, *FCT v Sherritt Gordon Mines Ltd*³⁷. In essence, royalty covers payments made in respect of the exercise of the right to take something that otherwise belong to someone else; and in particular, the above cases established that royalty has the following features:

- Payment made in return for the right to exercise a beneficial right;
- Payment made to the person who owns the right to confer that particular right;
- Consideration payable is determined on the basis of the amount of use made of the right acquired;
- Consideration payable will usually be paid as and when the rights are being used.

³⁵ (1955) 92 CLR 630

³⁶ (1944) 69 CLR 235

³⁷ (1977) 137 CLR 612

Use of or Right to Use a Copyright

Like the OECD definition, paragraph (a) of the Australian definition of “royalty” also encompassed payment for the use of, or the right to use, a copyright.

Whilst there is little guidance on the application of this aspect of the definition to e-commerce transactions in Australia, the general approach may be gleaned from the ATO’s thinking in relation to computer software. In Taxation Ruling TR 93/12, the ATO treats a payment for a licence to reproduce or modify software (that would otherwise constitute an infringement of copyright) as a royalty.³⁸ The Ruling, however, explicitly excludes from royalties for income tax purposes the followings:

- Payments for the granting of a licence that allows only duplication of the program as is necessary to enable the operation of the software. That is, where the payment is for a licence for “simple use” of computer software in the sense that the customer acquires only the right to run the program, and does not acquire the rights to use the copyright in the program.³⁹ It is considered that the amount of payment that relates to copying of the product is likely to be minimal, even if it is quantifiable.
- Payments in respect of the provision of services in the modification or creation of software; and
- Proceeds from the sale of goods. Where the transfer involves a sale of a copy of a program, it is accepted that the whole of the purchase price should be treated for tax purposes as the proceeds from sale of goods, notwithstanding that some part of that amount may be attributable to an express or implied licence to use the copyright in the program such as copying onto a hard disk drive.⁴⁰

From this it can be observed that the ATO have adopted a pragmatic approach, focusing on the commercial substance of the transaction, rather than one that merely looks at whether there is an infringement of copyright.

³⁸ Paragraph 3 of TR 93/12.

³⁹ Paragraph 27 of TR 93/12.

⁴⁰ Paragraph 34 of TR 93/12.

This ruling is in relation to “computer software”.⁴¹ It is unclear the extent to which this ruling is applicable to the characterisation of income in relation to the sale of digital products over the Internet.

In the absence of case law to the contrary, it seems, a case can be made that the payment is in the nature of royalty. For instance, if the digital product is a copyrighted song that the taxpayer has purchased from an online distributor, it is arguable that the payment is the consideration for the use of copyright. After all, the taxpayer would have the permission to make a copy of the song on his or her hard disk, perhaps even to make a copy of the song on some portable digital player. This would appear to fall within paragraph (a) of the royalty definition in sub-section 6(1) of the Act.

This view flows from a strict legal interpretation of the transactions as a matter of copyright law. If the transaction is analysed, the process would involve the saving of the computer codes that make up the software onto the hard disk of the customer’s computer; indeed, every time the person uses the software, codes are being transferred, copied or used by the various electronic components of the computer. For instance, some codes are definitely copied to the random access memory, some codes may reside in the cache or internal memory of the microprocessor. All of these involve the act of reproducing a copyrighted material. Technically, such reproduction constitutes use of copyright. Money paid for this transaction therefore is royalty because it is money paid for the use of the copyright.

Having said this, there is little reason to suggest that the treatment of digital products should be any different to computer software. The 1997 International Fiscal Association General Report has stated that:

“In many ways the treatment of Software may be the best preview of the manner in which countries would be prepared to address the taxation of e-commerce in the coming years.”

⁴¹ “Computer software” may be defined as “computer programs consisting of encoded instructions designed to cause a computer to perform a particular task or to produce a particular result.” (Paragraph 10 of TR 93/12).

Further, there are considerable support and push to extend similar software regulation in the US to transaction involving the transfer of other digital products.⁴² This also seems to be the position of the Final Report; although, as noted above, this is unclear.

In Australia, it is likely that the approach underpinning the characterisation of computer software transactions is the preferable position. The ATO has noted that it is likely to follow the international approach in area of e-commerce taxation.⁴³ Moreover, paragraph (d) of the Australian definition is logically consistent with the “essential consideration” approach of the TAG. That paragraph expressly includes in royalty any payment for the supply or assistance that is “ancillary and subsidiary to” enable the application or enjoyment of the property or know-how, irrespective of the extent to which the payments relate to the supply of the property or know-how. In other words, the focus is on the main purpose of the payment such that anything that is merely ancillary is grouped together for the purpose of characterisation.

This would not be the first time the ATO adopts a substance based approach in respect of royalty characterisation. In IT 2660, the ATO notes, in the context of whether the form of payment would determine its character, “[i]f, having regard to the substance of the contract, a payment falls within the scope of the definition, it will be royalty...”.⁴⁴

Consequently, the ATO’s position regarding computer software provides a guide as to how other e-commerce transactions are likely to be addressed. If this were the case, then downloading music, for example, from the Internet should not give rise to royalty payment especially in cases where the payment is:

- for the acquisition of the music; or
- for the granting of a licence that allows the person to a copy of the music so as to enable a rendition of the music.

⁴² Jensen, P. “Selected Issues in Cross-Border Electronic Commerce Transactions” (2001) 24 Tax Notes Int. 157. Also, the US Treasury indicated at the time of finalizing the software regulation that it may consider extending its principle to other digital product.

⁴³ Refer to the First Report and Second Report of the ATO.

⁴⁴ Paragraph 15 of IT 2660.

Synergies with Copyright Law

It has been noted that strict application of copyright law to an e-commerce transactions may result in a conclusion that the reproduction of copyrighted materials would constitute an infringement of copyright. It is interesting that recent amendments to the Australian Copyright law tends to be moving away from such a connotation.⁴⁵ For instance, the doing of the following would not give rise to a copyright infringement:

- Copies of computer software made in the normal course of running the program, for the purposes of developing interoperable products, security testing, error correction and making back-up copies do not infringe copyright.⁴⁶
- Temporary reproduction of a work that occurs as part of a technical process of making or receiving an electronic communication is not an infringement of copyright provided the making of the communication is not an infringement of copyright.⁴⁷

These exceptions are consistent with the principle of TR 93/12 as well as that of the Final Report. The broad thrust of the copyright provisions is that incidental use, or the right to use, copyright materials would not constitute an infringement of copyright.

Whilst the first exception above is confined to computer software, the second exception in relation to temporary reproduction is more interesting insofar that it could potentially be applicable to a wider range of e-commerce activities. There is little doubt that this exception covers browsing and certain types of caching (for example, by a software browser on a user's computer), an uncertainty is whether this exception applies to hypertext linking, framing, or caching by a proxy server. The potential nonetheless exist. Indeed, to the extent that this reflects the thinking or direction of the legislature, it may be that a more pragmatic and commercially

⁴⁵ Ie. Amendments made under the *Copyright Amendment (Computer Programs) Act 1999* (Cth).

⁴⁶ *Copyright Act 1968* (Cth) sections 47B-47F. An exception is where the running of the program is contrary to an express direction or licence of the copyright holder.

⁴⁷ *Copyright Act 1968* (Cth) sections 43A, 111A.

oriented application of the law represents the going forward position. This would be entirely consistent with the thrust of the Final Report.

Extended Definition of Royalty in Australia

The definition of royalty under the domestic legislation of Australia is very broad, and, as noted above, its scope extends beyond the ordinary meaning of the term. Its scope is broader than the OECD definition, which is essentially the ordinary meaning of the term plus a few extension to ensure coverage of things like know-how, right to use industrial, commercial or scientific equipment.

Inconsistent classification of transaction between Australian domestic law and OECD model may arise. For example, under Category 26, which involves the provision of streamed web based broadcasting in real time, the TAG considered that both subscription and advertising revenues would result in Article 7 business profits. In Australia the issue arise as to whether the subscription to receive the web based broadcasting would amount to a royalty under the extended definition of royalty in sub-section 6(1), on the basis of sub-paragraph (da) or (db).⁴⁸

In relation to the subparagraph (da), it is clear here that the payment is for the reception of visual and sound transmitted by some form of cable technology. An uncertainty is whether it is “transmitted to the public”. This is arguably the case as the signal is send out on the cable or whatever broadband distribution network to the world at large in the sense that anyone (with the necessary equipment) can access the video stream. Indeed, under copyright law the words “to the public” would seem to have a broad scope in that the High Court held in *Telstra v APRA*⁴⁹ that playing ‘music on hold’ constitutes a transmission “to the public” on the premise that the transmission is done as part of a commercial setting.

However, technically, a counter argument can be made that the “packet” constituting the signals is only directed towards a particular machine or IP address on the internet and hence not really for transmission to the public at large.

⁴⁸ Refer to above on page 12.

⁴⁹ (1997) 146 ALR 649.

In addition, it could also be said that the payment is for the use of visual or sound in connection with Television or radio broadcasting under sub-paragraph (db). Indeed, this argument would be all the more stronger if the provider is one already possessing a broadcasting licence!

Summary and Comments

In summary, it can be observed that whilst there are no authoritative position in relation to the characterisation of e-commerce transactions in Australia, the little administrative guidance there are available, in the form of ATO public ruling on computer software, do support the view that characterisation of e-commerce transactions are following much the same line as that advocated by the TAG in its Final Report. That is, the logic behind the “simple use” notion in the ATO ruling and the TAG’s “essential consideration” is such that mere copyright law infringement is ignored.⁵⁰ Further, in the case of Australia, even domestic copyright law seems to be evolving in a direction that is consistent with this overarching substance based approach.

This approach is arguably sensible for a number of reasons. First, given the instantaneous nature of downloading a product in e-commerce transactions, it is unreasonable to preoccupy the analysis on the few seconds that it takes to download the digital product.⁵¹ The true economic nature of the transaction is that the user is paying for the privilege to use the digital product itself, not just for the right to make some copies!

Second, it is consistent with the “neutrality” principle that has been widely accepted.⁵² The Internet, or electronic medium, is but a mode of delivery that should not affect the characterization of the transaction. If the downloading of digital product is treated as giving rise to royalty, the neutrality principle is arguably violated in that had the digital product (eg. a computer program) been delivered via CD-ROM it is

⁵⁰ Even US regulation follows this line. See Reid, T., *op. cit.*

⁵¹ Sprague, G. and Schindler, O., *op. cit.*

⁵² Refer to OECD Committee on Fiscal Affairs, “Electronic Commerce: Taxation Framework Conditions” (8 October 1998); Australian Taxation Office, “Tax and the Internet” (August 1997) at 92; United States Department of the Treasury, Office of Tax Policy, “Selected Tax Policy Implications of Global Electronic Commerce” (November 1996) at 19.

undoubtedly a sale of good for tax purpose and not as a royalty income. So why should the mere fact that the delivery is electronic make a difference!

Third, taxing such transactions as a business profit is consistent with fundamental international tax principle.⁵³ Business profit are taxed on a net basis in recognition of the fact that the vendor's economic profit needs to take into account its operating expenses. By contrast, royalty is taxed on a gross basis on the premise that there are no or very little operating expenses such that the gross amount approximates the true economic profit. With e-commerce transactions, the fact is that there are substantial operating and overhead expenses such as development, procurement, marketing, sales and administration. In other words, the income is still very much an active business income; the electronic means of delivery does not transform it into some form of passive income.

Fourth, the classification as business profit is more efficient from a tax administration and compliance perspective. Large volume, low-price transactions such as these become very difficult to track.⁵⁴ It would be difficult for the ATO to enforce royalty withholding tax in respect of a large number of small hidden transactions.⁵⁵

Fifth, this approach avoids the inconsistency, anomalous outcomes and interpretation difficulties that may arise under a strict copyright law approach.⁵⁶

BUSINESS PROFIT VERSUS PAYMENT FOR KNOW-HOW

Payment for the transfer of know-how is often included as part of the royalty article in bilateral tax treaty. Under the OECD Model Tax Convention “know-how” is referred to in the royalty definition as “payments received as consideration for information concerning industrial, commercial or scientific experience”.⁵⁷ Whilst the Final Report acknowledged that “e-commerce transactions resulting in know-how payments are

⁵³ Refer to Sprague, G. and Schindler, O., *op. cit.* at p269.

⁵⁴ Sprague, G. and Schindler, O., *op. cit.* at p269.

⁵⁵ Latham, C. “Internet Commerce: The Internet as a Commonwealth Tax Challenge” (2000) 4 The Tax Specialist 65.

⁵⁶ See Sprague, G. and Schindler, O., *op. cit.* at p270 for a discussion of these issues.

⁵⁷ Paragraph 2 of Article 12 of OECD Model Tax Convention.

relatively rare”,⁵⁸ the report nonetheless considered at lengths the distinction between business profits and payments for know-how, and even recommended that the Commentary be modified to provide additional guidance given the difficulty of drawing this distinction in practice.

The Final Report endorsed the current definition of “know-how” in the OECD Commentary, which define know-how as:⁵⁹

“undivulged technical information that is necessary for the industrial reproduction of a product or process, directly and under the same conditions; inasmuch as it is derived from experience, know-how represents what a manufacturer cannot know from mere examination of the production and mere knowledge of the progress of technique”

This is contrasted to a services contract, in which the person “use the customary skills of his calling” to execute the contract.⁶⁰

The Final Report also outlined some additional indicia to aid the distinction between know-how and services. In this regard, these indicia are drawn heavily from Taxation Ruling IT 2660 issued by the ATO and computer software regulation issued by the United States Inland Revenue Services (IRS) and Treasury.

In broad terms, the Australian ruling takes the position that a know-how contract involves the transfer of pre-existing knowledge for the use of the buyer, with the provider remaining free to use the knowledge itself or to transfer it to others; by contrast, a services contract involves an undertaking to perform services that will result in the creation of a product that belongs to the buyer. Further, the level of expenditure is expected to be higher in relation to a contract for the performance of services in that little generally needs to be done in supplying know-how which, by

⁵⁸ Paragraph 17 of the Final Report.

⁵⁹ Paragraph 11 of the Commentary on Article 12.

⁶⁰ *Ibid.*

definition, is already in existence. These principles are captured by proposed changes to the OECD Commentary.⁶¹

Category 14 provides an illustration of these principles. This transaction involves the provision of online technical support such as installation advice and trouble-shooting information. The Final Report does not regard this as providing know-how because the transaction is more about the provision of actual services performed on demand, rather than a transfer of know-how. This is notwithstanding that the provision of trouble-shooting information is based on the information contained within a trouble-shooting database. In this regard, the Final Report noted that “undivulged technical information” is limited to information “necessary for the industrial reproduction of a product or process” and that “information that merely relates to the operation or use of products as opposed to their development or production” is not know-how.⁶² By contrast, Category 19 shows that technical information about a secret manufacturing process would be a know-how.

For e-commerce transactions involving computer program the approach of the US software regulation is adopted by the Final Report. Under the US software regulation, the development and modification of a computer program is regarded as services, whereas computer programming techniques itself is the know-how. In particular, a payment will only be taken to be from the provision of know-how if the information relates to computer programming techniques, is furnished under a confidential arrangement, and is subject to trade secret protection.⁶³ Consequently, the Final Report recommended that the Commentary be changed such that the transfer of information concerning computer programming be regarded as know-how only if it is “information constituting ideas and principles underlying the programs, such as logic, algorithms or programming languages or techniques”, as well as requiring that the

⁶¹ Refer to Final Report, Annex 1, page 17.

⁶² Final Report, Annex 2, Paragraph 23.

⁶³ Refer to Regulations 1.861-18(e). Cf. In Canada, a royalty can arise when computer software is transferred subject to a restriction requiring the source code to be kept confidential. See Schickli, W. “Characterization of E-Commerce Revenue- The Final OECD Report Revealed” (2001) 22 Tax Notes Int. 1671.

information be provided under confidentiality agreement and subject to trade secret protection.⁶⁴

Synergies with Australian Law

The characterisation of a payment as know-how or service under Australian law and tax treaty (as modified by the TAG recommendation) is likely to be fairly harmonious. This follows from the fact that the TAG grounded their approach on the ATO tax ruling IT 2660. However, there are subtle differences that may result in different characterisation. For instance, under the US software regulation, whose principles are also adopted by the TAG, know-how will only arise in respect of programming technique where there is a confidentiality agreement and where the information is subject to protection under trade secret law. This is not the case in Australia

Further, given the unclear scope of know-how under paragraph (c) of the royalty definition in Australian,⁶⁵ uncertainties could arise as to whether a payment is in respect of know-how. One transaction that is certain is that the payment for the supply of the source code or algorithms of a computer program would, *prima facie*, falls within paragraph (c).⁶⁶

PAYMENT FOR THE USE OF INDUSTRIAL, COMMERCIAL AND SCIENTIFIC EQUIPMENT

In most bilateral treaty involving Australia, the definition of royalties covers “payment for the use of, or the right to use, industrial, commercial or scientific equipment.”⁶⁷ In such treaties, this provides another basis to distinguish between royalties and business profit. In fact, this definition tends to extend the coverage of

⁶⁴ Final Report, Annex 1, p18.

⁶⁵ A problem that even the Commissioner acknowledged in Taxation Ruling IT 2660.

⁶⁶ See Taxation Ruling TR 93/12, paragraph 39.

⁶⁷ Note that on 27 September 2001 a protocol was entered into between the Australian and United State government that removes, amongst other amendments, this aspect of the royalties definition.

the royalty clause to leasing income that would otherwise fall under the business profits clause.⁶⁸

The Final Report distinguished between two broad items: (i) the use of digital products, and (ii) the use of computer hardware. The payment for the use of computer hardware may involve the use of industrial, commercial and scientific equipment; whereas, the conclusion of the Final Report is that time-limited use of digital product cannot be considered as payments for the use of, or the right to use, industrial, commercial or scientific equipment for the following reasons:⁶⁹

- (i) Digital products are not within the meaning of the term “equipment” as it refers to tangible product;
- (ii) Digital products are not “industrial, commercial or scientific”, especially insofar that it is provided to private consumers; and
- (iii) Payments are not considered to be “for the use, or the right to use” the digital products because of the short useful lives of these digital product.

Category 5 provides an illustration of this. It seems that the focus is very much on the use of something that is physical – in the form of some equipment – and in cases involving software alone this can never be satisfied. In e-commerce transactions, such as application hosting, web site hosting and data warehousing (such as Categories 7, 8, 9 11 and 13), the answer once again hinges upon whether the contract or licence give the user control or possession over the equipment. If it does, then the payment would be a royalty under tax treaty that includes such a clause. Further, note that apportionment may be required where the contract is regarded as a mixed contract.⁷⁰

This approach to classification adopts the essential consideration principle noted previously. That is, notwithstanding that the digital product may be delivered via a tangible media, which the minority in previous meeting of TAG considered to be “equipment”, the final view is that the tangible media do not constitute a significant

⁶⁸ This in fact is one reason why this definition has been removed from the CECD Model Convention. See discussion in paragraph 9 of the Commentary to Article 12.

⁶⁹ Paragraph 26 of the Final Report.

⁷⁰ Refer to below on page 30.

portion of the consideration and so it is effectively disregarded for the purpose of characterisation. This is sensible and reflects reality as the customer is paying for the content, not the box that it came in. This is also consistent with the approach under US software regulation that ignores the medium of delivery.⁷¹

Interestingly, the Final Report made no any recommendation to change the current OECD Commentary in relation to payment for the use of, or the right to use, industrial, commercial or scientific equipment. This raised the question: to what extent is this view of the TAG relevant to tax treaty characterisation in Australia? Is it binding to an Australian Court?⁷²

Limited Duration Software in Australia

In Australia, a payment under such a licensing arrangement to use softwares, which may include the right to make such copies as is necessary to operate the program in accordance with the license, is not royalties. In this regard, Taxation Ruling TR 93/12 states that “the amounts attributable to the right to load a program onto the user’s computer or computers would strictly be royalty, but accepts that the amount, if quantifiable, is likely to be minimal.”⁷³ That is, for a limited life software product and other digital licenses, the payment is for the right to use the product with limited and incidental right to reproduce the software for the purposes of making proper use of it. Once again this is an application of the “simple use” concept, where the focus is on what is being transferred rather than how. It is a sale of a product where copyright is reserved in the copyright holder. Therefore, the proceeds from such sale would be business profit irrespective of whether it involves the delivery of actual physical disks or the product is delivered through the Internet.

The Final Report comments in relation to “payments for the use of, or the right to use, industrial, commercial or scientific equipment” is also relevant to Australia as Australian law would treat such payment as royalties. Consistent with the TAG’s view, it seems unlikely that Australia would treat the products in this case as an “equipment” because they lack a tangible form. Indeed, it seems somewhat absurd to

⁷¹ Sprague, G. and Schindler, O., *op. cit.* at p273.

⁷² See *infra* at page 36.

⁷³ Paragraph 27 of TR 93/12. Refer also to Tax and the Internet: Second Report para 5.4.50.

treat physical distribution of CD as a scientific apparatus and the delivery of the software contained within the CD through the Internet as not involving any equipment.

TECHNICAL FEES

The Final Report also addresses the treatment of so called “technical fees” clauses in tax treaty. Such clauses typically give the source country taxing right over services of a technical, managerial or consultancy nature. The TAG concluded that the mere use of technology or provision of information is not adequate.⁷⁴

In the case of “technical services”, the services provided must:

- Involve special skills or knowledge related to a technical field (such as that of applied science or craftsmanship, but not the arts or human sciences); and
- Such skills and knowledge must be required at the time the service is provided to the customer.

The mere use of technology to provide or deliver a service does not make that service a technical service, otherwise absurd result will arise; for example, every services provided over the Internet would be regarded as technical services! Consequently, transaction such as data warehousing (Category 13), web hosting (Category 11) and application hosting (Category 7) should not give rise to any technical fees because no special skill or knowledge is exercised at the point of delivery. By comparison, the provision of customer support over a computer network, as in Category 14, would fall within “technical fee” as special skill or knowledge is required at point of delivery.

Similarly, “managerial services” requires that the services be rendered in performing managerial functions as commonly understood in the business parlance. Moreover, as in the case of technical fee, the mere provision of management information and software is not sufficient to constitute managerial services. Likewise, “consultancy services” requires services constituting the provision of advice by someone, such as a

⁷⁴ Refer to paragraphs 39 to 45 of Final Report.

professional, who has special qualifications allowing him to do so. An example of this can be found in Category 18.

It is interesting that under the Final Report, Categories of transactions involving human are taken to fall within “technical fee” clause, whereas those that are automated and without human involvement do not give rise to technical fees. So is the test really: whether there is any human involvement? If so, does this mean that if a transaction that used to be carried out by human is automated, would the transaction be re-characterised? In this regard, Category 14 tends to follow this line of thinking as it tries to distinguish between customer support delivered personally and customer support through queries to a database.

It would seem that as “services become more automated, applying these principles will become more difficult.”⁷⁵

SERVICES VERSUS PROPERTY TRANSACTIONS

The TAG also considers the distinction between provision of services and transfer of property. Typical e-commerce transactions that raise this issue includes:⁷⁶

- A customer receives the right to use software or other digital product on a one-time basis, either used remotely or downloaded without the ability to make copies, other than as required for the intended singular use;
- Application-hosting arrangements or in data search and retrieval transactions.

Whilst the OECD Model Convention does not contain such a distinction, it is recognised that many bilateral tax treaties do, especially those that adopt language similar to the United Nations Model Convention. Further, this distinction is closely related to the issue concerning “payment for the use of, or the right to use, industrial, commercial or scientific equipment”, and also concerning fees for “technical services”. The distinction between property and services transaction is a threshold

⁷⁵ Sprague, G. and Schindler, O., *op. cit.* at p275.

⁷⁶ See Hardesty, D. “Character of E-Commerce Transactions Part 1” (2001) <<http://www.commercetax.com/doc/051301.htm>>.

issue. If it is a property transaction, the first issue may need to be considered; whereas, if it is a service transaction, then the second issue may be relevant.

Computer Equipment

In relation to computer equipment the TAG borrows from the distinction between rental and service contract under the US Internal Revenue Code, which provides the following indicia of a rental (i.e. property) transaction:

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

Application of this rule is best illustrated by, and most relevant to, application services provider and data warehousing transactions. Reference can be made to Category 7, 8, 9, 11 and 13 in this regard. Application hosting typically involves the provision of software to customer, where the software are stored and executed on the provider's server. Similarly, in a data warehousing arrangement, the service provider stores the customer's information on equipment owned and operated by the service provider. That is, in both situation, the service provider owns and operates the necessary hardware, and the customer merely have access to use these hardware. Consequently, the Final Report concluded that such transactions are services in nature.

The distinction between services and property transaction involving tangible computer equipment is relatively clear, but the same cannot be said for transaction

concerning intangibles.

Intangibles and Other Non-Computer Hardware Products

The general rule adopted by the TAG is that if the customer owns the relevant property after the transaction, but the property, which include a digital product,⁷⁷ was not acquire from the provider, then the transaction should be treated as a service transaction.⁷⁸ This typically means that if one party engages the other to create a property, such as to commission the other to write software, the transaction is a service transaction. The general rule is supplemented by a rule that states that in a transaction involving the provision of services, any acquisition of property that is “merely ancillary”, such as those with low intrinsic value, is disregarded in terms of characterisation.⁷⁹ This means that a sale income would arise if a customer acquires “property” not specifically prepared for the customer, such as an “investment report or other high-value proprietary information”, similar to Category 18, and the property is made available to many customers.

From the Final Report classification of various transactions, it can be observed that the characterisation issue is very much a question of fact. Subtle difference can result in a different classification. This can be seen in a comparison of Category 21 and Category 28. Under Category 21, the provision of access to an interactive web site is characterised as a service as “the payment is mainly for the interaction with the site for purposes of the personal enjoyment of the user”⁸⁰ Compare this with Category 28 which involves a subscription to a web site that allows the downloading of digital products. This transaction is classified as a property transaction because the essential consideration is for the acquisition of digital products or content (which is music in this case).

⁷⁷ Eg. copy of electronic data, software program, digitised music or video images, as well as other forms of digital information and content.

⁷⁸ Paragraph 33 of the Final Report.

⁷⁹ Paragraph 35 of the Final Report.

⁸⁰ Final Report, Annex 2, page 30.

With respect, this can be a very fine distinction, which may not be easy to apply in practice. When is the user paying for the interaction with a web site? And when are they paying for downloading some thing from the site? What about interactive web site that involves downloading as well? Indeed, what is a “digital product” in this regard? Does it have to be computer software? Is text, or graphics, enough?

Underscoring this point is Category 6 where the TAG is unable to come to a consensus. This transaction involves the single-use of a digital product. Some consider that this is a property transaction, but others consider that the single-use product is not transferred for a long enough period of time to be regarded as a sale or rental.⁸¹

What about subscription to access an online database, such as the LEXIS research facilities?⁸² Following the logic of Category 21, this could be regarded as a services transaction as the fee is for gaining access to an interactive web site. But what happen when the user downloads an article that he or she found? If the subscription is taken to be a service initially, then would the subsequent act of download transforms the character to a property transaction on the basis that the transaction involves the transfer of a ‘digital product’. The answer is not clear. This uncertainty is reflected in Category 15 and 16 where the TAG is unable to come to a consensus in respect of transaction involving retrieval of data and the delivery of exclusive or high value data. Some see this as services as they consider the fee as payment for the ability to search and extract documents, while others see this as payment to obtain the data.

TREATMENT OF MIXED PAYMENTS

Under the OECD Commentary, mixed transaction – transactions that comprises of different categories – is required to be split into component parts and each part separately characterised.⁸³ An exception is where a component is “of ancillary and largely unimportant character.”⁸⁴ In other words, this is a *de minimis* exclusion.

⁸¹ Refer to the Second Draft paragraphs 41 and 63.

⁸² <http://www.lexis.com/>

⁸³ OECD Commentary on Article 12, paragraph 11.

⁸⁴ *Ibid.*

During the TAG various meetings, it was suggested that the focus should instead be on the predominant character of a mixed or integrated transaction, such that this predominant character becomes the character of the transaction as a whole. This approach is said to simplify characterisation. The argument is that there is no need to artificially split payments that, from a commercial perspective, is regarded as source from a single transaction. To require bifurcation would impose an unreasonable and impractical compliance burden. This view was not accepted by the TAG in the Final Report.

The current requirement to apportion the transaction is considered to be appropriate. The Final Report did, however, provide a slight change: if one element in the transaction is “by far the principal purpose” and the other elements are “ancillary and unimportant”, the recommendation is that the treatment applicable to the principal part “should” apply to the whole consideration.⁸⁵ This provides a much more certain treatment, especially when compared to the current Commentary that merely states that “it seems possible” to apply the principal characterisation to the whole transaction.⁸⁶

Situation dealing with mixed payment is illustrated in Category 12 in respect of software maintenance. In this instance, if the provision of services in the form of maintaining software is the principle part of the transaction, and where other aspect is merely ancillary and merely unimportant character, the payment would fall within Article 7 business profit. If part of the payment involves the provision of technical support, it may be that the “technical fee” clause would be triggered. While it is conceivable that part of software maintenance may involve the supply of know-how, it seems unlikely that know-how will be provided in the ordinary course of providing software maintenance.

Is Bifurcation Required In Australia?

The use of the phrase “to the extent to which” in the Australian definition of royalty indicates that a payment or credit may be dissected or apportioned into its royalty and

⁸⁵ Paragraph 47 of the Final Report.

⁸⁶ Refer to OECD Commentary to Article 12, paragraph 11.

non-royalty components. This view is acknowledged by the Commission in paragraph 13 of Taxation Ruling IT 2660. Further, the same ruling in paragraph 35 notes that where “both know-how and services (*other than ancillary services*) are supplied under the same contract, an apportionment of the two elements of the contract should be made.” (emphasis added) Therefore, it can be said that the Australian position is largely consistent with the current OECD approach, namely that mixed transaction is required to be split into its royalty and non-royalty part for instance, except where the component is merely ancillary to the transaction.

The recommendation of the TAG in the Final Report arguably makes the OECD position even closer to the current Australian approach. Whereas previously the Commentary merely indicates that “it seems possible”⁸⁷ to split the transaction, the recommended changes is that the transaction “should”⁸⁸ be splitted in mixed contract situation.

PRACTICAL MATTERS

This final section comments on the application of TAG’s recommendations to non-extreme situations and the implication for tax planning.

Non-Extreme Cases

The 28 categories presented by the TAG in the Final Report tend to be rather extreme in terms of their factual settings. This makes characterisation relatively simple, but in practice classification may not be that straight forward. Category 3, for instance, falls on the extreme end of the business profit and royalty dichotomy. Here, there is no doubt that the payment is for the use, or the right to use, a copyright because the substance of the transaction is clearly one of exploitation of the copyrighted materials, rather than the means of acquiring the products. Extreme cases like these are simple to resolve. More troublesome are the multitudes of ‘in-between’ cases.

The TAG distinguished between transactions involving “personal use” and those involving commercial exploitation. It may not be entirely clear in practice as to

⁸⁷ OECD Commentary on Article 12, paragraph 11.

⁸⁸ Final Report, Annex 1, p18.

whether the transaction is for commercial exploitation or whether it is merely for the “personal use” of the customer. This would seem to require an understanding, on the part of the vendor, of the customer’s intention. This requires knowledge of what they are going to do with the products. Is this realistic? Given that a vendor would need to withhold an amount in most cases where the payment is a royalty, the vendor needs to make this determination for each transaction. How should they do this? Should they require the customer to fill in a form to state their intention? Alternatively, the terms of the transactions or contract may need to make this intention clear. Obviously, structuring is possible here.

Consider another example, Category 4, which involves the provision of updates and add-ons to digital products. The Final Report concluded that this transaction would give rise to business profit. Under the facts as presented, this is the logical conclusion. However, upon a closer examination, different scenario could arise in relation to such add-ons and updates, including:

- (i) provision of service facility;
- (ii) outright sale;
- (iii) licence to use the updates;
- (iv) supply of know-how.

Whilst there is little doubt that the first three situations would give rise to business profit, royalty may arise under situation (iv). This would fall within paragraph (c) of Australia royalty definition, as well as under most tax treaty on the basis that it is the payment for the supply of scientific, technical, industrial and commercial knowledge or information – “know how”. The updates or add-ons transaction may give rise to know-how in two broad situations. One situation in which this may give rise to a royalty is where the digital product falls within Category 3 in the first instance such that the purpose of downloading the product is for the commercial exploitation of the copyright. The character of the subsequent updates or add-ons would flow from this purpose.

Even if the digital product does not fall within Category 3, and instead falls within,

say, either Category 1 or 2, there could be a supply of know-how where, for example, the updates or add-on represents some sort of techniques or knowledge supplied by the provider. For example, the downloading of a firmware update to, say, a portable MP3 player to enable it to play the latest MP3 format. The firmware update has these features:

- It involves the transfer of a product in the form of information, technique and process;
- It is transferred to the customer for his or her use;
- The property in the firmware is retained by the provider, in that the customers merely have the right to use it.

This is squarely within the ambit of know-how under IT 2660 which was adopted by the TAG in the Final Report.⁸⁹ It could further be argued that the “essential consideration” here is to supply the know-how to the customer, rather than for the customer to acquire the knowledge embodied in the updates.

Double Taxation or Planning Opportunities?

Although the definition of royalty under Australia tax legislation is broadly consistent with the OECD and TAG’s definition, there are subtle differences as noted in previous sections of this paper; and consequently, it is possible that anomalies may arise in terms of characterisation of a transaction. Double taxation may follow, which in theory should be resolved under tax treaty (if there is one).⁹⁰ However, anomalies also mean there could be planning opportunities. In this regard, a few observations on TAG’s recommendations are noted here.

First, whilst the “essential consideration” approach is pragmatic and is arguably appropriate in the majority of cases, it may be that there are situations in which this approach is too simplistic such that it places a gloss over the transaction. Indeed,

⁸⁹ Refer to supra on page 20.

⁹⁰ It is interesting to note that some suggest that tax treaty is not necessary to prevent double taxation, rather an unilateral approach can work. See Dagan, T. “The Treaties Myth” (2000) 32 N.Y.U.J. Int’l L & Pol. 939..

taken to the extreme, it would appear that reliance of this rule would empower manipulation, or in practical terms, planning opportunities.

For instance, as noted above,⁹¹ the Final Report determines whether the download of digital product (other than computer software) is royalty on the basis of its intended use; in particular, if it is for “personal use”, it would *not* be regarded as royalty. This means to the extent it is possible to establish that the download is not for personal use, then the payment in respect of the download would not be a royalty. This opens up choices: for example, by making it clear in any contract what the parties think the payment is for, it may be possible to ‘pre-specify’ the character of the transaction as either royalty or business profit depending on which characterisation is more tax efficient.

It is curious that the TAG stops short of saying that no royalty would arise unless there is a commercial exploitation of copyright.⁹² Such a statement would make it more difficult to construct an arrangement to ‘artificially’ fall within the royalty category.

Second, the treatment of mixed contract situation under the OECD Commentary and under Australian law also raises interesting possibilities. By ensuring that the “principal part” of the contract involves the use of some copyright, for example, the whole payment would be characterised as a royalty, and hence, as a result be taxed at the royalty withholding tax rate of 15-30%. This is notwithstanding that part of the payment may be more accurately classified as a business profit (eg. because it involves the provision of certain services) that would otherwise be subject to the higher corporate tax rate.

Of course, whether it is practical or feasible to structure a transaction in this manner in the e-commerce arena awaits to be seen. Nevertheless, there is clearly no reason against this, especially given that the e-commerce business model is still evolving.

⁹¹ See *supra* on page 32.

⁹² The TAG did seriously debate the proposition that “royalty characterisation could not arise in the absence of a transfer of rights to allow a commercial exploitation of the copyright by the transferee.” Strange that no conclusion was reached and no reference was made to it in the Final Report.

The ease with which this can be pursued may turn on the meaning of “principal” in this regard. The word “principal” arguably refers to a threshold of at least 50%.⁹³ This may be contrasted with “predominant” which connotes a threshold of much more than 50%. Coincidentally, it can be noted that the proposal in the second draft TAG report to insert this higher threshold of “predominantly” was not taken up in the final TAG report. An overriding criterion that still needs to be satisfied is that the non-principal part needs to be of an “ancillary & largely unimportant character”.⁹⁴ This may not be easy to fulfil. But there are certainly scopes for creative structuring as what is ancillary or unimportant is a question of fact.

At the end this comes down to value judgement. Clearly, there are scopes to manipulate the facts to ensure a particular outcome is achieved. The TAG Final Report does not change this. The positive side is that the report provides a common framework to address characterisation issues. At the very least, the end-points, or the extreme cases, are defined and there is an international consensus.

Planning with the TAG rules in mind are well and good, but this begs the question: can the TAG’s recommendation be relied upon? This paper turns to this issue next.

Legal Status of the TAG Recommendations

It is clear that double tax agreements of which Australia is a party have the force of law and would be binding to any tribunals or courts in Australia.⁹⁵ It is also clear that whilst the OECD Commentary is not legally binding, it can be relied upon to provide assistance with the interpretation of the tax agreement.⁹⁶ The importance of Commentary as an aid to tax treaty interpretation is referred to by all High Court judges in *Theil v FCT*⁹⁷. The established principle of interpretation of treaty in this

⁹³ In a recent ruling by the ATO in the context of personal services income, the Commissioner noted that the word “mainly” is similar to word like “chiefly”, “principally” or “primarily” and that they means at least 50%. (TR 2001/7)

⁹⁴ Paragraph 49, p16 of the Final Report.

⁹⁵ Pursuant to the *International Tax Agreement Act 1953*.

⁹⁶ Note 31 at Introduction of the OECD Commentary, p29 provides: “Although the Commentaries are not designed to be annexed in any manner to the conventions signed by Member countries, which unlike the Model are largely binding international instruments, they can nevertheless be of great assistance in the application and interpretation of the conventions...”

⁹⁷ 90 ATC 4717.

regard requires that the interpretation be based on the “ordinary meaning” of the terms in the treaty as determined by their context, as well as any subsequent agreement and practice, and also based on any “special meaning” that is intended by the parties.⁹⁸

What is less clear, and is the source of much debate is whether changes to the Commentary after conclusion of the tax treaty can or should be taken into account. Using the Commentary in force at the time of conclusion of the treaty is well accepted and reasonable enough,⁹⁹ but to import a meaning that is determined after the conclusion of the tax treaty raises the question whether that interpretation is really what the party intended.

Whilst the answer is not clear-cut, the better view is that amendments post-conclusion of tax treaty can still serve as a supplementary means of interpretation.¹⁰⁰ As a supplementary means of interpretation such material can only be relied upon if the materials confirm an interpretation based on the principle noted above, or, if such an interpretation results in an interpretation that is ambiguous or obscure or lead to a result that is absurd or unreasonable.¹⁰¹ This would seem to curtail the circumstances in which the amended Commentaries can be used to aid interpretation. However, in a medium that is so new, it is submitted that the Court would or should place substantial reliance on such materials in interpreting the tax treaty. This would help promote a consistent international treatment. In Australia, there is little reason why the Courts would not adopt such an approach. Indeed, in *FCT v Lemesa*¹⁰², it was noted, as an *obiter dictum*, that limit should not be imposed on the range of materials that may be referred to in interpreting a tax treaty.

CONCLUSION

With characterisation playing a pivotal role in the determination of tax consequences of cross-border transactions, it is most welcoming to see the release of the Final

⁹⁸ Article 31 of the Vienna Convention on the Law of Treaties.

⁹⁹ Tillinghasat, D. “Are Tax Treaties Necessary” (1999) 53 Tax L. Rev. 1., Vogel, K. “The Influence of the OECD Commentaries on Treaty Interpretation”, Bulletin-Tax Treaty Monitor, December 2000.

¹⁰⁰ Vogel, K., *op. cit.*

¹⁰¹ Article 32 of the Vienna Convention on the Law of Treaties.

¹⁰² (1997) 77 FCT 597.

Report that endorses a uniformed approach, one that is not based on the legalistic interpretation of copyright law, but instead, is grounded in pragmatism. The TAG Final Report, at the very least, provides a common framework to address the characterisation issue.¹⁰³ Moreover, if its recommendations are incorporated into the OECD Commentary, additional certainty will exist in relation to the characterisation of cross-border e-commerce transactions, and hence minimising the possibility of double taxation.

Applications of the TAG recommendations, including the broad principle of essential consideration and treatment in respect of mixed contract, is straightforward in well defined and extreme case, as were in the categories identified in the TAG report. Real-life scenario are likely to be less clear-cut and that scope for structuring and planning would continue to exist. Planning exercise should take the TAG recommendations into consideration. Even though it is likely to amount to no more than a supplementary means of interpretation in Australia, it is fair to say that it would be rather persuasive in nature, in that it is consistent with the general thrust of public rulings issued by the ATO and the development of copyright law in Australia.

¹⁰³ See Schickli, W. "Characterization of E-Commerce Revenue- The Final OECD Report Revealed" (2001) Tax Notes Int1671., Sprague, G. and Schindler, O., *op. cit.*

BIBLIOGRAPHY

- Andrews, W. 'A Platform for International E-Commerce Tax Rules- Part 2: What Should the New Rules Look Like?' (2001) 12 J. of Int. Tax. 10.
- ATO Discussion Report of the Australian Taxation Office Electronic Commerce Project Team, "Tax and the Internet" , August 1997.
- ATO *Second Report of the Australian Taxation Office Electronic Commerce Project Team*, "Tax and the Internet" , December 1999.
- Ault, H. *Comparative Income Taxation: A Structural Analysis* (1997), Kluwer Law International, Den Haag, The Netherlands.
- Basu, S. 'Taxation of Electronic Commerce' (2001) The Journal of Information, Law and Technology <<http://elj.warwick.ac.uk/jilt/01-2/basu1.html>>.
- Canada Electronic Commerce and Canada's Tax Administration, A Response by the Minister of National Revenue to His Advisory Committee's Report on Electronic Commerce (September 1998).
- CSIRO 'Electronic Commerce Project' (1997) <<http://www.ato.gov.au>>.
- Dagan, T. 'The Treaties Myth' (2000) 32 N.Y.U.J. Int'l L & Pol. 939.
- De Zilva, A. 'Tax and E-Commerce' in International Tax Master Class- New South Wales Division , Taxation Institute of Australia, 31 August 2000.
- Doernberg, R. 'Electronic Commerce: Changing Income Tax Treaty Principles a Bit?' (2000) 21 Tax Notes Int. 2417.
- Doernberg, R. and Hinnekens, L. *Electronic Commerce And International Taxation* (1999), Kluwer Law International, The Hague, Netherland.
- Goulder, R. 'OECD Treaty Characterization TAG Finds Consensus on E-Commerce Tax Issues' (2000) 21 Tax Notes Int. 2335.
- Hardesty, D. 'Character of E-Commerce Transactions Part 2' (2001) <<http://www.ecommercetax.com/doc/052001.htm>>.
- Hardesty, D. 'Character of E-Commerce Transactions Part 1' (2001) <<http://www.ecommercetax.com/doc/051301.htm>>.

- Hardesty, D. 'Character of E-Commerce Income: Revised Report' (2000) <
<http://www.ecommercetax.com/doc/092400.htm>>.
- Imparato, N. *Public Policy and the Internet* (2000), Hoover Institution Press,
Stanford, California.
- Jensen, P. 'Selected Issues in Cross-Border Electronic Commerce Transactions'
(2001) 24 Tax Notes Int. 157.
- Latham, C. 'Internet Commerce: The Internet as a Commonwealth Tax Challenge'
(2000) 4 The Tax Specialist 65.
- O'Donnell, T., Levey, M. and Power, J. 'International Tax Issues For Cyberspace
Transactions' (2000) <<http://www.bmck.com/ecommerce/cyber.doc>>.
- OECD 'Electronic Commerce: Taxation Framework Conditions' A Report by the
Committee on Fiscal Affairs, as presented to Ministers at the OECD
Ministerial Conference, "A Borderless World: realising the Potential of
Electronic Commerce" on 8 October 1998.
- OECD Report of the Technical Advisory Group to Working Party No.1 of the OECD
Committee on Fiscal Affairs, "Tax Treaty Characterisation Issues Arising
for E-commerce", 1 February 2001.
- OECD "Electronic Commerce: The Challenges to Tax Authorities and Taxpayers", A
discussion paper presented to the OECD Electronic Commerce
Conference in Turku, Finland, November 1997.
- OECD "Electronic Commerce: A Discussion Paper on the Taxation Issue", A
discussion paper presented to the OECD Government/ Business dialogue
on Tax and Electronic Commerce held in Ottawa., October 1998.
- OECD 'The Economic and Social Impact of Electronic Commerce: Preliminary
Findings and Research Agenda' (1999)
<http://www1.oecd.org/subject/e_commerce/ebooks/027-054.pdf>.
- OECD committee on Fiscal Affairs 'Clarification on the Application of the Permanent
Establishment Definition in E-Commerce: Changes to the Commentary on
the Model Tax Convention on Article 5', 22 December 2000.
- Reid, T. 'Tax characterization on Electronic Commerce Revenue' (2000) 1 E-

Commerce Tax Report 197

<<http://www.bmck.com/ecommerce/ecomrev.pdf>>.

Revenue Canada *Electronic Commerce and Canada's Tax Administration*, April 1998.

Rice, V. 'E-Business Lessons From Luxury',

<<http://www.zdnet.com.au/newstech/ebusiness/story/0,2000024981,20222166,00.htm>>.

Schickli, W. 'Characterization of E-Commerce Revenue- The Final OECD Report Revealed' (2001) 2 April 22 Tax Notes Int.1671.

Scott, D. 'E-Commerce' in 30 August 2001 4th Annual Victorian State Convention , Taxation Institute of Australia, 30 August 2001.

Sprague, G. 'Electronic Commerce: Character And Source Issues'

<<http://www.bmck.com/ecommerce/ecomcharsouriss.doc>>.

Sprague, G. and Schindler, O. 'Another Step Towards Uniformity- relative Consensus of the OECD TAG on Income Characterization of E-Commerce Transactions' [2001] Tax Management Int J 267.

Tillinghasat, D. 'Are Tax Treaties Necessary' (1999) 53 Tax L. Rev. 1.

United Kingdom's Inland Revenue and HM Customs and Excise *Electronic Commerce: UK Taxation Policy* , October 1998, .

US Government Report 'Selected Tax Policy Implication of Global Electronic commerce ' (1996) <<http://www.treas.gov/taxpolicy/internet.html>>.

Vogel, K. 'the Influence of the OECD Commentaries on treaty Interpretation' [2000] Bulletin - Tax Treaty Monitor 612.

APPENDIX 1: SUMMARY OF OECD FINAL REPORT'S 28 CATEGORIES OF E-COMMERCE TRANSACTIONS

<i>Categories</i>	<i>Business Profit (Article 7)</i>		<i>Technical Fees Clauses</i>	<i>Royalty (Article 12)</i>		
	<i>Services</i>	<i>Non-Services (ie. transfer of property)</i>		<i>Know-how</i>	<i>Right to use Copyright</i>	<i>Right for the use of, or the right to use, industrial, commercial or scientific equipment</i>
1. Electronic order processing of tangible products	-	√	-	-	-	-
2. Electronic ordering and downloading of digital products	-	√	-	-	-	-
3. Electronic ordering and downloading of digital products for purpose of commercial exploitation of copyright	-	-	-	-	√	-
4. Updates and add-ons	-	√ ¹	-	-	-	-
5. Limited duration software and other digital information licenses	-	√ ²	-	-	-	X
6 Single-use software or other	√	√ ³	-	-	-	-

¹ Treated like transactions in Category 1 and 2, depending whether the updates and add-on are delivered in a tangible medium or electronically respectively.

² Treated like transactions in Category 1 and 2.

Characterisation of E-Commerce Transactions

digital product						
7. Application hosting- separate license	√	-	X ⁴	-	-	X ⁵
8. Application hosting – bundled contract	√	-	√ ⁶	-	-	X ⁷
9. Application service provider (ASP) ⁸	√	-	√	-	-	X ⁹
10. ASP License fees	√	-	-	-	X ¹⁰	-
11. Web site hosting	√	-	X	-	-	X
12. Software maintenance	√	-	√ ¹¹	-	-	
13. Data warehousing	√	-	X ¹²	-	-	X
14. Customer support over a computer network	√	-	X ¹³	X	-	-
15. Data retrieval	√ ¹⁴	√ ¹⁵	X	-	-	-

³ Some members consider this to be similar to Category 2 and 5.

⁴ Usually not regarded a providing any special technical skill or knowledge where service being provided merely that of storing data and software – ie. warehousing function.

⁵ Usually not, as customer do not usually have control over the equipment.

⁶ Eg. to the extent part of the payment relates to the provision of technical support. Apportionment of the payments into various components may be required.

⁷ Final Report did not really say, but likely to be similar to Category 7.

⁸ This raises issues similar to Category 8 above.

⁹ Final Report did not really say, but likely to be similar to Category 7.

¹⁰ Not that there is no use of copyright, but such use is regarded to be a minimal part of the consideration.

¹¹ But this may not be the case if the situation describe in Category 14 apply, refer to footnote below.

¹² Refer to footnote 4.

¹³ Ie. if support merely involves provision of access to a troubleshooting database and necessary software to access the information

Characterisation of E-Commerce Transactions

16. Delivery of exclusive or other high-value data ¹⁶	√	√	X	-	-	-
17. Advertising	√	-	-	-	-	X
18. Electronic access to professional advice (eg. consultancy)	√	-	√	X	-	-
19. Technical information	-	-	-	√	-	-
20. Information delivery ¹⁷	√	√	X	-	-	-
21. Access to interactive web site	√	-	X	-	-	-
22. Online shopping portals	√	-	-	-	-	-
23. Online auctions	√	-	-	-	-	-
24. Sales referral programs	√	-	-	-	-	-
25. Content acquisition transactions	-	√ ¹⁸	-	-	√ ¹⁹	-
26. Streamed (real time) web based broadcasting	√	-	-	-	-	-
27. Carriage fees	√				X ²⁰	

¹⁴ Some see this as payment for the ability to search and extract documents.

¹⁵ Some see this as payment to ultimately obtain the data.

¹⁶ This is very similar to Category 15 above.

¹⁷ Regarded to be similar to Category 15 above.

¹⁸ If payment is for the “creation of new content and, as a result of the relevant contractual arrangement, becomes the owner of the copyright so created.” (Paragraph 39 of the Final Report).

¹⁹ If payment is for “the right to display copyrighted material” (Paragraph 39 of the Final Report).

Characterisation of E-Commerce Transactions

28. Subscription to a web site allowing the downloading of digital products	-	$\sqrt{21}$	-	-	X	-
---	---	-------------	---	---	---	---

²⁰ Cannot be a royalty since it is the owner of the copyrighted material that makes the payment.

²¹ This category is more similar to Category 2 than to Category 21.