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Tax consequences of the digitalized economy – issues of relevance for developing countries

Secretariat Note

Summary

This note proposes some purely editorial changes to the approved text for Article 12B and its Commentary, as forecast prior to the adoption of those texts at the 22nd session. It makes the changes agreed to in the Committee discussion of CRP.17, and proposes a small number of additional changes since suggested by Members.

The Committee is invited to approve the editorial changes in the attached Annex at the 22nd Session.

Summary

At its current session, the 22nd, the Committee adopted the text of Article 12B and its Commentary as annexed to the Co-Coordinators' report on the work of the Subcommittee on Tax Consequences of the Digitalized Economy - *(E/C.18/2021/CRP.1) Tax consequences of the digitalized economy – issues of relevance for developing countries*.

2. In adopting that text, it was recognized that further purely editorial (i.e. non-substantive) changes would be needed prior to inclusion in the 2021 update of the UN Model Double Tax Convention. It was forecast that some would be introduced later in the Session, and some such changes were agreed in first consideration of CRP.17. They are incorporated in this revision in grey highlighting. A small number of *new proposed changes* are in marked up text highlighted in yellow.

3. Any further editorial changes would be as agreed by the Co-Coordinators of the relevant Subcommittee, consulting as they consider necessary, including with the Co-Chairpersons of the Committee. This is the usual procedure for purely editorial changes and will apply even after the Subcommittee itself has completed its work.

4. The annexed editorial changes ***are submitted for Committee approval at the 22nd Session.***

Annex:

Editorial Changes to Article 12B and Commentary

(A) Article 12B

ARTICLE 12B – INCOME FROM AUTOMATED DIGITAL SERVICES

1. Income from automated digital services arising in a Contracting State, underlying payments for which are made to a resident of the other Contracting State, may be taxed in that other State.

2. However, subject to the provisions of Article 8 and notwithstanding the provisions of Article 14, income from automated digital services arising in a Contracting State may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the income is a resident of the other Contracting State, the tax so charged shall not exceed ____ percent *(the percentage is to be established through bilateral negotiations)* of the gross amount of the payments underlying the income from automated digital services.

3. The provisions of paragraph 2 shall not apply if the beneficial owner of the income from automated digital services, being a resident of a Contracting State, requests the other Contracting State where such income arises, to subject its qualified profits from automated digital services for the fiscal year concerned to taxation at the tax rate provided for in the domestic laws of that State. If the beneficial owner so requests, subject to the provisions of Article 8 and notwithstanding the provisions of Article 14, the taxation by that Contracting State shall be carried out accordingly. For the purposes of this paragraph, the qualified profits shall be thirty percent of the amount resulting from applying the profitability ratio of that beneficial owner's automated digital services business segment to the gross annual revenue from automated digital services derived from the Contracting State where such income arises. Where segmental accounts are not maintained by the beneficial owner, the overall profitability ratio of the beneficial owner will be applied to determine qualified profits. However, where the beneficial owner belongs to a multinational enterprise group, the profitability ratio to be applied shall be that of the business segment of the group relating to the income covered by this Article, or of the group as a whole in case segmental accounts are not maintained by the group, provided such profitability ratio of the multinational enterprise group is higher than the aforesaid profitability ratio of the beneficial owner. Where the segmental profitability ratio or, as the case may be, the overall profitability ratio of the multinational enterprise group to which the beneficial owner belongs is not available to the Contracting State in which the income from automated digital services arises, provisions of this

paragraph shall not apply; in such a case, the provisions of paragraph 2 shall apply.

4. For the purposes of paragraph 3, “multinational enterprise group” means any “group” that includes two or more enterprises, the tax residence for which is in different jurisdictions. Further, for the purposes of paragraph 3, the term “group” means a collection of enterprises related through ownership or control such that it is either required to prepare Consolidated Financial Statements for financial reporting purposes under applicable accounting principles or would be so required if equity interests in any of the enterprises were traded on a public stock exchange.

5. The term “automated digital services” as used in this Article means any service provided on the Internet or another electronic network, in either case requiring minimal human involvement from the service provider.

6. The term “automated digital services” includes especially:

- Online advertising services;
- Supply of user data;
- Online search engines;
- Online intermediation platform services;
- Social media platforms;
- Digital content services;
- Online gaming;
- Cloud computing services; and
- Standardized online teaching services.

7. The provisions of this Article shall not apply if the payments underlying the income from automated digital services qualify as “royalties” or “fees for technical services” under Article 12 or Article 12A as the case may be.

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

(a) such permanent establishment or fixed base, or

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

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

9. For the purposes of this Article and subject to paragraph 10, income from automated digital services shall be deemed to arise in a Contracting State if the underlying payments for the income from automated digital services are made by a resident of that State or if the person making the underlying payments for the automated digital services, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to make the payments was incurred, and such payments are borne by the permanent establishment or fixed base.

10. For the purposes of this Article, income from automated digital services shall be deemed not to arise in a Contracting State if the underlying payments for the income from automated digital services are made by a resident of that State which carries on business in the other Contracting State through a permanent establishment situated in that other State or performs independent

personal services through a fixed base situated in that other State and such underlying payments towards automated digital services are borne by that permanent establishment or fixed base.

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

(B) Draft Commentary on Article 12 B

INCOME FROM AUTOMATED DIGITAL SERVICES

A. General considerations

1. Digital technology has had a very significant impact on how cross border business activities can be carried out at a very large scale, with high speed and without necessarily having a physical presence in the market jurisdiction (source jurisdiction). The question has arisen whether the existing rules under tax treaties allocating taxing rights amongst countries based on permanent establishment criteria are any longer appropriate in respect of the new business models based on digital technologies. The concept of permanent establishment effectively acts as a threshold and only where this threshold is met, is any taxation in the market jurisdiction possible under most of the existing tax treaty rules. The concept of permanent establishment in Article 5 is essentially based on a fixed place of business, and also includes service or construction activities carried on for a specific duration, the existence of a dependent agent and the collection of insurance premiums. However, with the advent of modern means of telecommunications and the spread of digitalization, enterprises have the ability to effectively engage in substantial business activities in the market country without a fixed place of business there, or to conclude contracts remotely through technological means with no involvement of individual employees or dependent agents.

2. Tax consequences of digitalized economies, especially from the point of view of developing countries were therefore recognized as a matter of importance by the Committee, which first engaged itself in this work during its 15th Session. The Committee identified income from automated digital services as a matter of priority to be dealt with and decided to focus on a tax treaty provision under the United Nations Model Convention that would enable jurisdictions to apply their domestic legislation levying taxes on income derived from digital business models. The Committee’s approach has been to find a solution, which is relatively simple to comply with by business as well as tax administrations and at the same time, results in a definite share for market jurisdictions. As a result of these considerations, Article 12B was added to the United Nations Model Convention in 2021 to preserve the domestic law taxing rights for States from which payments for automated digital services are made.

3. Article 12B allows a Contracting State to tax income from certain digital services paid to a

resident of the other Contracting State on a gross basis at the rate negotiated bilaterally and specified in paragraph 2 of the Article with an option to the taxpayer to pay tax on a net profit basis for the whole year under paragraph 3 of the Article. Under Article 12B, a Contracting State is entitled to tax payments for automated digital services if the income is paid by a resident of that State or by a non-resident with a permanent establishment or fixed base in that State and the payments are borne by the permanent establishment or fixed base. Automated digital services are defined to mean services provided on the Internet or digital or other electronic network requiring minimal human involvement from the service provider. Until the addition of Article 12B, income from automated digital services, derived by an enterprise of a Contracting State (unless it also fell within scope of Articles 12 or 12A) was taxable exclusively by the State in which the enterprise was resident unless the enterprise carried on business through a permanent establishment in the other State (the source State) or provided professional or independent personal services through a fixed base in the source State and the income from automated digital services was effectively connected with such permanent establishment or fixed base..

4. The taxation of income from automated digital services on a gross basis under Article 12B may result in double or other excessive taxation. Although the rate is to be bilaterally negotiated, the possibility of double or excessive taxation can be taken into account by having a modest rate (i.e. 3 or 4 per cent) of tax on the income from automated digital services under paragraph 2 of Article 12B. Moreover, paragraph 3 allows the non-resident provider to require taxation on a net basis by following the global profitability ratio of the beneficial owner or the multinational enterprise group to which it belongs . Where the enterprise belongs to a multinational enterprise group, the option for net basis taxation is subject to availability of information to the source jurisdiction about the profitability ratio of the automated digital services business segment or of the group as a whole. The possibility that payments in consideration for automated digital services may be subject to double or excessive taxation is also reduced or eliminated under Article 23 (Methods for the Elimination of Double Taxation).

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

6. While paragraph 5 notes the possibility of implementing this tax by way of a withholding tax, the Article itself lays down nothing about the mode of taxation in the State in which the income from automated digital services arises. Therefore, it leaves that State free to apply its own laws and, in particular, to levy the tax either by deduction at source or individual assessment. As with other provisions of the United Nations Model Convention, procedural questions are not dealt with in this Article. Each State is able to apply the procedure provided in domestic law.

7. Article 12B does not require any particular threshold, such as a permanent establishment, fixed base, or minimum period of presence, in a Contracting State as a condition for the taxation of income from automated digital services. In this regard, modern methods for the delivery of services allow non-residents to render substantial services for customers in the other country with little or no presence in that country. This ability to derive income from a country with little or no physical presence there is considered by the Committee to justify source taxation of income from automated digital services.

8. A large minority of the members of the Committee did not agree with the argument set forth in paragraph 1 of the Commentary to Article 12B that the advent of modern means of telecommunications and the ability to conclude contracts remotely without the involvement of individual employees or dependent agents, on its own, justifies the allocation of taxing rights over the revenue of the enterprises, in particular multinational enterprise groups, to the source jurisdiction (sometimes referred to as “market jurisdiction”) in the manner provided for in Article 12B. These members did not agree that taxing rights should be allocated to the source jurisdiction based on mere sales. Further, these members did not agree that the market, on its own, generates profits from activities under the scope of Article 12B such that the market jurisdiction should be allocated taxing rights.

9. Those members recognized that the digitalization of the economy and, in particular, certain highly digitalized business models have caused tax challenges and accentuated the question of whether traditional concepts of nexus and income allocation lead to appropriate results in light of such business models. However, these members considered the reallocation of profits of a multinational enterprise group to the market jurisdiction to be a multilateral issue which is best suited for a comprehensive multilateral solution, not a bilateral approach. In their view, it is not clear that the entity within the multinational enterprise group that ultimately provides the automated digital service has earned that part of the worldwide profit of the multinational enterprise group that should be reallocated to the market jurisdiction. These members supported continued work on a comprehensive multilateral solution. Further, those members considered that if a multilateral solution is reached and widely adopted, the interaction of Article 12B with such multilateral solution will need to be considered, especially to ensure that concerns regarding double and multiple taxation are not exacerbated.

10. Those members were also concerned that Article 12B does not comprehensively address the tax challenges related to the digitalization of the economy. For example, the sourcing rule in paragraph ~~8~~ 9 of Article 12B, deeming the payment to arise in the State in which the payer is resident, in their view unduly limits the scope of the Article as it does not fully address the value generated by data collected in relation to users of free digital services (e.g., search engines and social media platforms). Further, these members questioned the rationale for the allocation of taxing rights in the case of “online advertising services”, which is one of the biggest sources of income in ADS. In many cases, the entity paying for the advertisement and the target of the advertising (user of ADS) are located in different states. In such a situation, Article 12B would not convey any taxing right to the market state where the user is located. Rather than reallocating taxing rights to the market jurisdiction, Article 12B would allocate taxing rights based on the location of the entity paying for the advertisement.

11. Further, a source right to tax the payment may allow digital companies to structure their business models to avoid making the payment in a particular country that has such source taxing rights. It was also noted by those members that the exclusion for permanent establishments in paragraph 10 of the Article will limit the application of Article 12B. Further, those members were of the view that given the scope limitations of Article 12B, it is not clear that the “definite share for market jurisdictions” referred to in paragraph 2 of this Commentary will be significant, especially for small developing countries.

12. These members were concerned that the term “income from automated digital services” as used in the Article is not clear. These members also considered that several terms and concepts used in paragraph 3 of the Article, in the related Commentary or otherwise relevant to the application of the net basis taxation option (for example, “automated digital services business segment”, “segmental accounts”, “segmental profitability ratio”, the need to determine an

allocation of indirect costs to the automated digital services business segment and the determination of profit before tax, and address situations where consolidated accounts do not exist and different accounting standards are used for different entities within the multinational enterprise group) were insufficiently defined or explained in the Commentary and too much flexibility was left to individual countries to define the terms in their domestic law. These members were therefore concerned that the application of the Article would result in increased uncertainty, inconsistent treatment, and lengthy disputes between taxpayers and tax authorities. Further, they considered that information to justify the profitability ratio of the multinational enterprise group, as required for paragraph 3 of the Article to apply, may not be in in the taxpayer's possession or control. In order for this net taxation option to work in a consistent manner, those members regarded it as critically important that a model of the domestic law framework be developed and followed by states implementing such a tax and that more guidance on the required information to justify the segmentation and required profitability ratios be provided by tax administrations. These members were also concerned that the complexity and administrative burden required for an entity to justify the required profitability ratios would make the net option unadministrable in practice or the option would be denied by the tax administration in the source state on the basis that insufficient information was provided.

13. In the view of these members, a further problem with the taxation of income from automated digital services on a gross basis – and even on a net basis given the reliance on the profitability ratio of the multinational enterprise group – is that it can lead to excessive or double taxation noting also the arguments raised in paragraph 9 of this Commentary concerning the multilateral character of the taxation of multinational enterprises. They considered that imposition of a tax on a gross basis denies the taxpayer the ability to take into account expenses that were incurred in connection with the provision of the services, which would be deductible if tax were imposed on a net basis. Thus, it is possible that the residence State's remedies with a view to relieving double taxation may not be adequate to fully relieve the gross-basis taxation imposed by the other State. The imposition of tax on a net basis, which relies on the greater of the profitability ratio of the taxpayer and the multinational enterprise group, means that the service provider may be subject to tax even if the service provider is in a loss position.

14. These members were concerned that certain design choices (such as applying to small payments and payments by individuals acquiring services for personal use) may significantly increase the administrative burden of the Article's application by some developing countries that have limited administrative capacity, without a clear indication that such choices will increase potential revenues to outweigh the cost of such choices. Countries sharing these concerns may wish to consider including a threshold (for example, a threshold based on the size of the taxpayer or the multinational enterprise group and a threshold based on the revenue arising in the source jurisdiction) and excluding payments by individuals acquiring services for personal use from the application of Article 12B similar to the exclusion for individuals acquiring services for personal use from the application of Article 12A (Fees for Technical Services). Such simplifications and other alternatives for simplification proposed by these members are set out in paragraphs ~~25,42, 44 and 48~~ 25-26, 4~~2~~3, ~~44 and~~ 48 and 65 of this Commentary.

15. As a matter of broader economic policy, these members were concerned that, as a result of the Article, consumers of automated digital services in the source State may encounter higher prices for those services, because foreign service providers could pass added tax costs on to the consumer through means such as so-called "gross-up" clauses in contracts. Typically, a gross-up clause will specify a net amount that the provider will receive, effectively passing the burden of any withholding tax on the consumer of the services. The use of gross-up clauses could result

in the tax being shifted to the consumer and make it more expensive to purchase the services. This can, in the view of those members, put a foreign service provider at a competitive disadvantage, effectively foreclosing access to a market that imposes such a withholding tax and restricting the consumer's legitimate choice of suppliers.

16. In summary, countries sharing these concerns may wish not to include Article 12B in their bilateral tax treaties.

17. In case income from automated digital service falls within the purview of both Article 12B and Article 7, paragraph 6 of Article 7 provides that the provisions of Article 12B prevail. However, this priority for Article 12B does not apply if the beneficial owner of the income from automated digital services carries on business through a permanent establishment in the Contracting State in which the income arises, and the income from those services is effectively connected with the permanent establishment or business activities referred to in clause (c) of paragraph 1 of Article 7. In this situation, paragraph 7 of Article 12B provides that the provisions of Article 7 apply instead of Article 12B.

18. In order to reduce uncertainty and inconsistencies, paragraph 7 explicitly clarifies that Article 12B does not apply to income from automated digital services where such income also qualifies as a "royalty" or as a "fee for technical services" falling under Article 12 or 12A, as the case may be.

19. Paragraph 6 of the Article lists examples of services that will often constitute automated digital services. However, the provision is not self-standing – in any particular case a service also has to meet the requirements of paragraph 5 for it to be an automated digital service for the purposes of the Article. The relationship between those paragraphs is addressed further at paragraph 57 of this Commentary.

20. Due to the nature of the automated digital services, it is unlikely that income from automated digital services would be dealt with in both Article 12B and Article 14. Nevertheless, to avoid uncertainty, both paragraphs 2 and 3 explicitly provide that Article 12B applies to income derived from automated digital services also falling within the scope of Article 14. However, if the beneficial owner of the income performs independent personal services in the Contracting State in which the income from automated digital services arises through a fixed base situated in that State and the income from automated digital services is effectively connected with the fixed base, paragraph 7 of Article 12B provides that the provisions of Article 14 would apply instead of Article 12B.

B. Commentary on the paragraphs of Article 12B

Paragraph 1

21. This paragraph establishes that the income from automated digital services arising in one Contracting State, underlying payments for which are made to a resident of the other Contracting State may be taxed in the other Contracting State. It does not, however, provide that such income is taxable exclusively by the State of residence.

22. The term "payment" has a broad meaning consistent with the meaning of the related term "paid" in Articles 10 and 11. As indicated in paragraph 3 of the Commentary on Article 10 (quoting paragraph 7 of the Commentary on Article 10 of the OECD Model Convention) and paragraph 6 of the Commentary on Article 11 (quoting paragraph 5 of the Commentary on Article 11 of the OECD Model Convention), the concept of payment means the fulfilment of the

obligation to put funds at the disposal of the service provider in the manner required by contract or custom. The expression "automated digital services" is defined in paragraph 5 to mean any service provided on the Internet or digital or other electronic network requiring minimal human involvement from the service provider.

23. Article 12B deals only with income from automated digital services arising in a Contracting State and paid to a resident of the other Contracting State. It does not, therefore, apply to income from services arising in a third State. Paragraph 9 and paragraph 10 of Article 12B specify when income from automated digital services is deemed to arise in a Contracting State and when it is deemed not to arise in a Contracting State, respectively. However, unlike Article 10, which does not apply to dividends paid by a company resident in a third State, Article 12B applies to income from automated digital services paid by a resident of a Contracting State or a third State where the payments are borne by a permanent establishment or fixed base that the resident has in the other Contracting State.

Paragraph 2

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

25. A large minority of members were of the view that it would be desirable to include thresholds for the application of Article 12B to reduce the population of taxpayers that would be subject to possible excessive taxation as a result of applying source taxation on a gross basis to automated digital services.. Such thresholds could be, for example, a threshold based on the worldwide revenue of the taxpayer for the purpose of protecting small-size taxpayers which may find the harsh result more difficult to bear than larger taxpayers, and a threshold based on the revenue from automated digital services derived from the source State for the purpose of protecting taxpayers that have just entered a particular market, since they would more often be operating at a loss during the start-up stage.

26. States seeking a result in line with the minority view expressed in the preceding paragraph may wish to agree bilaterally to replace paragraph 2 of the Article by the following:

> *2. However, subject to the provision of Article 8 and notwithstanding the provisions of Article 14, income from automated digital services arising in a Contracting State may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the income is a resident of the other Contracting State, the income from automated digital services arising in a Contracting State may be taxed in the Contracting State in which it arises only if:*
>
> > *(a) the worldwide revenue derived by the beneficial owner of the income during the fiscal year concerned is an amount exceeding___; and*
> >
> > *(b) the revenue from automated digital services derived by the beneficial owner from the Contracting State during the fiscal year concerned is an amount exceeding___;*
>
> *and the tax so charged shall not exceed ___ percent of the gross amount of the income from automated digital services arising in the first-mentioned State.*

27. When considered in conjunction with Article 23 (Methods for the Elimination of Double

Taxation), paragraph 2 establishes the primary right of the Contracting State in which income from automated digital services arises to tax it in accordance with its domestic law (subject to the limitation on the maximum rate of tax if the beneficial owner of the income is a resident of the other Contracting State). Accordingly, the country in which the recipient of the income is resident is obligated to eliminate double taxation of those payments. Under Article 23 A or 23 B, the residence country is required to provide relief from double taxation through the exemption from tax of the income from automated digital services or the granting of a credit against tax payable to the residence country on the income from automated digital services for any tax imposed on such income by the other Contracting State in accordance with Article 12B. In this regard, where a country applies the exemption method under Article 23 A, it is entitled to apply the credit method under paragraph 2 of Article 23A with respect to items of income taxable under Article 10, 11, 12, 12 A or 12B. A resident of State R, deriving income from State S, may have a loss in State R, or in State S or in a third State. For purposes of the tax credit, in general, a loss in a given State will be set off against other income from the same State. When the total income is derived from abroad, and no income but a loss not exceeding the income from abroad arises in State R, then the total tax charged in State R will be appropriate to the income from State S, and the maximum deduction which State R is to allow will consequently be the tax charged in State R. Other solutions are possible. As indicated in paragraph 66 of the OECD Commentary on Article 23 B quoted in paragraph 16.7 of the Commentary on Article 23, some States are very liberal in applying the credit method. Some States are also considering or have already adopted the possibility of carrying over unused tax credits. Contracting States are, of course, free in bilateral negotiations to amend the Article to deal with any of the aforementioned issues. Consequently, whether the tax paid in the source State according to Article 12B is relieved in the State of residence in the same year or in subsequent years would depend on the domestic laws and practice of each State.

28. The maximum rate of tax on income from automated digital services is to be established through the bilateral negotiations between the Contracting States. Although, the rate is to be bilaterally negotiated, it is recommended to be set at a modest value, i.e.: 3 or 4per cent.

29. A precise level of taxation at source on payments in consideration of automated digital services should take into account several factors, including the following:

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

30. The requirement of beneficial owner is included in paragraph 2 to clarify the meaning of the words "payments made to a resident" as they are used in paragraph 1 of the Article. It clarifies

that a Contracting State is not obliged to give up taxing rights over income from automated digital services merely because such payments underlying such income were made directly to a resident of another State with which the first State had concluded a convention.

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

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

33. It would be equally inconsistent with the object and purpose of the Convention for a State to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person which in fact receives the benefit of the income concerned. For these reasons, the report from the OECD's Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies"[2] concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has as a practical matter very narrow powers which render it in relation to the income concerned a mere fiduciary or administrator acting on account of the interested parties.

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

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

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

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

36. The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments[3] that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e., individuals), cannot be reconciled with the express wording of Article 10, subparagraph 2(a), which refers to the situation where a company is the beneficial owner of a dividend. In the context of Articles 10, 11, 12, 12A and 12B, the term "beneficial owner" is intended to address difficulties arising from the use of the words "paid to" in relation to dividends, interest, royalties and fees for technical services as well as the words "payments made to" in relation to income from automated digital services, rather than difficulties related to the ownership of the underlying property or rights in respect of which the amounts are paid. For that reason, it would be inappropriate, in the context of these articles, to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement".[4]

37. Subject to other conditions imposed by the Article, the limitation of tax in a State remains applicable when an intermediary, such as an agent or nominee located in the other Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State.

38. To avoid uncertainty, it is stated explicitly in paragraphs 2 and 3 that they apply subject to the provisions of Article 8 and notwithstanding the provisions of Article 14. Under Article 8, profits

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

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

from the operation of ships or aircraft in international traffic derived by an enterprise of a Contracting State are taxable only in that State. Under Article 14, income from the performance of professional or other independent personal services by a person who is a resident of a Contracting State is taxable by the other Contracting State only if the services are performed through a fixed base in the other Contracting State that is regularly available to the person or if the person stays in that State for 183 days or more in any twelve-month period commencing or ending in the relevant fiscal period. However, due to the nature of automated digital services, it is unlikely that income from automated digital services is dealt with in Article 8 or in Article 14.

Paragraphs 3 and 4

39. Paragraph 3 gives the beneficial owner of the income from automated digital services, being the resident of a Contracting State the option to be taxed on a net basis for the whole year in the other Contracting State where the income arises, as an alternative to the taxation provided for in paragraph 2. According to this paragraph, the beneficial owner of the income may request the Contracting State where the income arises to be subject to taxation on its qualified profits, as defined in the paragraph. This option would provide relief in those cases where the taxpayer may have a lower tax liability than the liability determined under the provisions of paragraph 2 and also in cases where it has a global business loss or a loss in the relevant business segment during the taxable year.

40. Paragraph 3 defines the qualified profits to be 30 per cent of the amount arrived at by applying the profitability ratio of the beneficial owner's automated digital services business segment to the gross annual revenue derived from such services in the Contracting State where such income arises. Where segmental accounts are not maintained by the beneficial owner, the overall profitability ratio of the beneficial owner will be applied to determine the qualified profits. Gross annual revenue from automated digital services derived from the Contracting State where the income from automated digital services arises would be the sum total of payments underlying the income from automated digital services arising in that Contracting State in accordance with the sourcing rules in paragraphs 9 and 10 of Article, during the fiscal year.

41. A large minority of members were of the view that 30 per cent of group consolidated profits for net taxation may be too high and consideration should be given to bilaterally negotiating a rate that more accurately reflects the particular facts and circumstances.

42. Where the beneficial owner belongs to a multinational enterprise group, the profitability ratio to be applied shall be the profitability ratio of the group's automated digital services segment or the profitability ratio of the group itself if segmental accounts are not maintained by the group, provided the profitability ratio of the multinational enterprise group is higher than the profitability ratio of the beneficial owner at entity level. This is with a view to neutralizing the possible reduction of the profitability due to tax-driven related party transactions in the multinational enterprise group. Application of paragraph 3 in cases where the beneficial owner belongs to a multinational enterprise group is contingent on the availability of information about the profitability of the multinational enterprise group to the Contracting State where the income from automated digital services arises. In certain situations, this information may be available through country-by-country reports exchanged. Exchange of information mechanisms may be utilized to obtain this information in certain situations. The beneficial owner itself may also be able to obtain such information and provide the same to tax authorities while opting for net basis taxation under paragraph 3. Where such information is still not available to the tax authority, paragraph 2 shall prevail and the option given by paragraph 3 will not be applicable for an enterprise that belongs to a multinational enterprise group.

43. A large minority of members were concerned that requiring a beneficial owner forming part of a multinational enterprise group to use the higher of its profitability ratio and the profitability ratio of the multinational enterprise group, will add significant complexity, increases the risk that, even under a net basis option, tax could be imposed when the beneficial owner is in a loss situation and increases the risk of excessive and double or multiple taxation. An alternative to address the risk identified by these members is to amend paragraph 3 to require reference to only the profitability ratio of the beneficial owner, with the possible inclusion of an anti-abuse rule to address the majority's concern that the profitability of the beneficial owner may be reduced due to tax-driven related party transactions in the multinational enterprise group.

44. According to the international standards on transfer pricing[5], a multinational enterprise group is a group of associated enterprises with business establishments in two or more countries. Multinational groups of companies generally operate worldwide through locally incorporated subsidiaries or permanent establishments. For the purposes of paragraph 3, paragraph 4 provides a clear definition of ”multinational enterprise group” as any ”group” that includes two or more enterprises, the tax residence for which is in different jurisdictions. Further, the term “group” is defined as a collection of enterprises related through ownership or control such that it is either required to prepare Consolidated Financial Statements for financial reporting purposes under applicable accounting principles or would be so required if equity interests in any of the enterprises were traded on a public stock exchange.

45. A large minority of members believe that where the taxpayer has no presence and thus no functions performed in the source state, it should not be subject to taxation in the source state on its routine profits which are based on functions. Without any carve-out for routine profits from the profitability ratio, the source state could apply taxation on routine profits which have been taxed by states where routine functions are performed. This would give rise to double taxation and the residence state may find it unfair (e.g. in situations where the routine functions are performed in the residence state), or may be unable to provide a relief (e.g. in situations where the routine functions are performed in a third state).

46. It is also possible that the routine functions are performed in the source state itself. To give an example, a taxpayer derives automated digital services income from a source state and at the same time has a PE in that state which undertakes routine functions supporting the ADS activities undertaken by the taxpayer. In such a case the PE would have already been taxed in the source state on the routine profits it derives from undertaking the routine functions, which forms part of the profits the taxpayer derives for providing the ADS services in the source state. If no carve-out from the profitability ratio is provided for such routine profits, the source state would tax the same routine profits twice. These members support having a carve-out from the profitability ratio to reflect the routine profits attributed to the functions performed, risks assumed and assets employed.

47. The profitability ratio of the beneficial owner or the multinational enterprise group to which the beneficial owner belongs is understood to be the annual profits divided by the annual revenue, as revealed by the consolidated financial statements of the automated digital services business segment of the beneficial owner or of the group it belongs to, or of the beneficial owner or the group as a whole, as the case may be. Unless bilaterally agreed otherwise between the Contracting States, the profit to be used for calculating profitability would be the profit before tax as per accounts of the beneficial owner, or as per the consolidated accounts of the multinational

[5] i.e.: Practical Manual on Transfer Pricing for Developing Countries, United Nations, New York, 2021 and OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, OECD, Paris 2017 .

enterprise group[6], as the case may be, with adjustments such as for example exclusion of income tax expenses, exclusion of dividend income, and gains or losses in connection with shares, adding back expenses not deductible for corporate income tax purpose due to public policy reasons, etc.

48. States sharing the concerns set out in the minority views expressed in paragraphs 41, 43 and 45, and that wish to refer only to the profitability ratio of the beneficial owner, set a carve-out for routine profit from the profitability ratio and leave the share of qualified profit to be taxed in the source state to bilateral negotiations, may agree bilaterally to replace paragraph 3 of the Article by the following:

3. The provisions of paragraph 2 shall not apply if the beneficial owner of the income from automated digital services, being a resident of a Contracting State, ~~may~~ requests the other Contracting State where such income arises, to subject its qualified profits from automated digital services for the fiscal year concerned to taxation at the tax rate provided for in the domestic laws of that State. If the beneficial owner so requests, subject to the provisions of Article 8 and notwithstanding the provisions of Article 14, the taxation by that Contracting State shall be carried out accordingly. For the purposes of this paragraph, the qualified profits shall be ___ percent of the amount resulting from applying to the gross annual revenue from automated digital services derived from the Contracting State where such income arises:

(a) the automated digital services business segment profitability ratio of the beneficial owner where segmental accounts are maintained;

(b) the overall profitability ratio of the beneficial owner where segmental accounts are not maintained;

deducted by ___ percent deemed return on routine functions for providing the automated digital services.

Where the segmental profitability ratio or, as the case may be, the overall profitability ratio of the multinational enterprise group to which the beneficial owner belongs is not available to the Contracting State in which the income from automated digital services arises, provisions of this paragraph shall not apply; in such a case, the provisions of paragraph 2 shall apply.

49. In order to avoid disputes and to provide certainty, not many adjustments are envisaged to be made to the profit as per accounts when determining the profits to calculate the profitability for purposes of this paragraph. The profitability of the multinational enterprise group to be used for the purposes of paragraph 3 would be for the same fiscal year. The information concerning the profitability ratio of the multinational enterprise group may be furnished by the taxpayer along-with supporting evidence. The tax administration of the Contracting State where the income from automated digital services arises may in appropriate cases make cross verification of the correctness of a taxpayer declaration through various available exchange of information mechanisms.

50. Qualified profits have been deemed to be thirty per cent of the amount arrived at by applying profitability to the local revenue in recognition of the fact that the entire profits arising from the market jurisdiction cannot be attributed to it. The specific figure of thirty percent is adopted by the Committee to achieve certainty on the one hand and to provide a fair and reasonable share to both jurisdictions on the other, keeping in view the special role markets play in generation of profits from the activities under the scope of the Article. In arriving at a figure of thirty percent, the respective roles of assets, employees and revenue in generation of profits were assigned equal

[6]The relevant financial accounting standard for the MNE Group would be the financial accounting standard used by the ultimate parent entity in the preparation of its consolidated financial statements.

weight. Finally, in the view of the Committee, the figure of thirty per cent is a compromise to balance allocation between source and residence countries.

51. Qualified profits shall be taxable at the tax rate provided in the Contracting State’s domestic law. The domestic law may have a procedure for registration of such service providers as well as necessary forms to be filed for facilitating taxation of income from automated digital services in accordance with paragraph 3. Similarly, taxation at source, if any as per paragraph 2, should be taken into account against the tax liability determined at a later stage on the basis of paragraph 3.

Paragraphs 5 and 6

52. Paragraph 5 defines “automated digital services” for the purposes of Article 12B as any service provided on the Internet or digital or other electronic network requiring minimal human involvement from the service provider. Paragraph 6 lists examples of services that may constitute automated digital services.

53. A service is regarded as automated when the user is able to make use of service because of equipment and systems being in place, which allow the user to obtain the service automatically, as opposed to requiring a bespoke interaction with the supplier to provide the service. In determining whether a service requires minimal human involvement, the test only looks to the supplier of the service, without regard to any human involvement on the side of the user for example where the user may input certain parameters into an automated system to obtain a customized result. Furthermore, the definition focuses on provision of services and therefore does not include human involvement in creating or supporting or maintaining the system needed for provision of services, maintaining and updating the system environment, dealing with system errors, or making other generic, non-specific adjustments unrelated to individual user requests. The threshold of minimal human intervention would not be crossed where the provision of services to new users involves very limited human response to individual user requests / input at the service delivery point or where in individual cases involving particular, more complex problems, the programmes running the system direct the customer to a staff member.

54. An important indicator of the concept of automated services is whether there is ability to scale up and provide the same type of services to new users with minimal human involvement. This feature aims to identify automated digital services businesses that benefit from significant economies of scale, rather than to suggest that there is no human involvement required in the business. For many automated digital services businesses, developing the system that delivers the offered service may require a large degree of upfront human involvement and capital inputs such as creating algorithms to deliver the automated service including such features as tailoring the offering to user’s preferences. It distinguishes automated digital services businesses by looking to whether the marginal cost in terms of additional human involvement of providing the same services to additional users is nil or almost nil. In other words, once the service offering of an automated digital business is developed (such as a music catalogue or a social media platform), then the business can provide that service to one user, or to many more, on an automated basis with the same basic business processes. On the other hand, a non-automated digital business would see a proportionate increase in per unit costs in connection with providing the services to new customers.

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

methods, to regard a service as an automated digital service. It is also not affected by whether or not the service provider owns, leases or otherwise controls the transmission equipment.

56. The general definition of "automated digital services" in paragraph 5 is exhaustive and when read together with the list of specific services in paragraph 6 of Article 12B that will often constitute automated digital services, provides certainty combined with flexibility. The benefit of using a general definition supported by list of specific items of services is that it will be capable of accommodating rapid changes in technology that may give rise to new types of automated digital services not so far included or excluded in the specific lists in paragraphs 57 and 59 below respectively. If there are multiple supplies that are identifiable and substantive in their own right, then each individual supply is to be tested against the definition.

57. Paragraph 6 of the Article lists examples of services that will often constitute automated digital services. However, the provision is not self-standing. While paragraph 6 notes that online advertising services, supply of user data, etc., are common types of automated digital services, when one is looking at the operations of a particular beneficial owner or multinational enterprise group, the requirements of paragraph 5 must also be met. Paragraph 6 therefore simply provides an indication that an activity may constitute an automated digital service; it does not provide that an activity listed therein necessarily is an automated digital service. The following services are mentioned specifically in paragraph 6:

i. Online advertising services;
ii. Supply of user data;
iii. Online search engines;
iv. Online intermediation platform services;
v. Social media platforms;
vi. Digital content services;
vii. Online gaming;
viii. Cloud computing services; and
ix. Standardized online teaching services.

The categories are not mutually exclusive; for example, a digital content service could be funded in whole or in part by online advertising.

58. The above-listed services are described as follows:

(i) Online advertising services are understood as online services aimed at placing advertisements on a digital interface, including services for the purchase, storage and distribution of advertising messages, and for monitoring of advertising and measurement of its performance. It includes related systems for attracting potential viewers of the advertisements and collecting content contributions from them and data regarding them, including via the provision of services such as access to the digital interface. Online advertising services include direct advertising services, such as where social media platforms, online search engines, online intermediation platforms and digital content providers directly sell advertising inventory for display on the digital interfaces they operate. It also extends to automated systems and processes for the purchase and sale of advertising inventory (such as demand-side platforms, supply-side platforms, advertisement exchanges, advertisement verification services, etc.). Given the broad definition of "digital interface" it also includes online advertising displayed on an Internet-connected good ("Internet of things") provided that there is an identifiable revenue stream from that advertising.

(ii) Supply of data means the provision of data to a third-party customer in respect of users of a digital interface, which is collected, compiled, aggregated or otherwise processed into data through an automated algorithm. , Data in respect of users here refers to all directly or indirectly identifiable personal data, such as a user’s habits, spending, location, environment, usage of services, hobbies, or personal interests or preferences, including anonymized and aggregated data (such as geo-location information and user traffic levels). The source of data may be collected as raw data by the enterprise itself (e.g. the manufacturer/seller of a home heating system collecting data about energy use, or a social media company collecting data about its users) or it may be acquired from another business. The source of the data would not be relevant, provided that it is generated by a user through a digital interface.

(iii) Online search engines imply making a digital interface available to users for the purpose of allowing them to search across the Internet for webpages or information hosted on digital interfaces. Many online search engines are monetized through online advertising services and/or services transmitting data about users, which may constitute automated digital services under other clauses of this paragraph i.e. clause (i) and clause (ii) respectively. The category of ”online search engines” extends to instances where an online search engine charges users for access, for example under a subscription model, or where online search engine technologies are provided for incorporation into a third-party host website (e.g. a “search box”).This category does not include services such as online databases or ‘internal’ website search functions that are not monetized, where the search results are limited to data hosted on that same digital interface (or related digital interfaces). However, if an online database or an “internal” website search function service involves monetization of services and meets the general definition of automated digital service, it will be covered under Article 12B.

(iv) Online intermediation platform services involve a digital interface available to users for the purpose of enabling interaction among themselves, including for the sale, hire, advertisement, display or other offer by users of particular goods, services, user-generated content or other property to other users. It does not include the online sale of goods and services of the platform’s own inventory. This category applies where the service enables the interaction between third party users, irrespective of the nature of the interaction, the characteristics of the users involved, whether an underlying transaction is itself an automated digital service, or the extent of the service provider’s activities in facilitating the interaction. This category covers instances where the online intermediation platform charges users for its online intermediation services, for example through commission, listing or subscription fees. The intermediation service may at times be funded via online advertising or the sale of data, which constitute automated digital services under other clauses of this paragraph i.e. clause (i) and clause (ii) respectively.

(v) Social media platforms involve making a platform available on a digital interface to facilitate the interaction between users or between users and user-generated content. This category includes a range of activities such as social and professional networking websites, micro-blogging platforms, video or image sharing platforms, online dating websites, platforms dedicated to sharing user reviews, as well as online call and messaging platforms, some of which could overlap with online intermediation platforms. This category covers instances where the social media platform charges users for access, for example under a subscription model. These services may be funded via online advertising, the sale of data, or different subscription models such as for digital content services. Such services of online advertising etc. constitute automated digital services under other clauses of this paragraph. This category does not extend to instances where user interaction is merely incidental to the

core purpose of the digital interface, for example where a company sells its own inventory online and the website allows users to post comments or reviews or where a website allows a user to engage in an online chat with a sales representative.

(vi) Digital content services implies the automated provision of content in digital form, such as computer programs, applications, music, videos, books, other texts, games, online newspapers, online libraries, online databases and software, in each case other than the data represented by a digital interface, whether by way of online streaming, accessing or downloading digital content, whether for access one time, for a limited period or in perpetuity. This category captures the different forms which digital content can take when accessed by a user, but it does not include simply making a digital interface available to users. The purpose from a user's perspective in a digital service transaction is the ability to access the digital content. By way of background, the streaming and downloading consists of the same process of transmitting data, either as a continuous flow similar in effect to a temporary download or as a file saved to the user's device available for later use. A number of streaming services allow both temporary streaming and downloading, but from the perspective of the automated digital service provider, the process is essentially the same. Downloading of or access to software over the Internet also meets the general definition of automated digital service where it is automated requiring minimal human involvement to make the software available to users over the Internet. As such, software that is accessed or downloaded over the Internet would therefore qualify as automated digital service under the "digital content services" category, or it may also qualify under the "cloud computing" category ("Software-as-a-service"). Paragraph 61 of this Commentary below clarifies the interaction with other articles in cases where elements of income could be regarded as being covered by Articles 12 or 12A. Accordingly, Article 12B does not apply to the provision of software provided via streaming or downloading as digital content if the payment qualifies as a royalty under Article 12.

(vii) Online gaming means making a digital interface available for the purposes of allowing users to interact with one another in the same game environment. This category applies to all multiplayer gaming enabled by the Internet, such as massively multiplayer online games, or other games that enable multiplayer functionalities, and regardless of the device or platform through which the game is accessed. The provision of in-game purchases, or any other online purchases within the game is also under this category. This category does not include single-player games (which if streamed, accessed or downloaded over the Internet would be within the category of digital content services) or the purchase of a game sold on tangible media such as a DVD. ~~.~~

(viii) Cloud computing services are those providing standardized on-demand network access to information technology resources, including infrastructure as a service, platforms as a service, or software as a service (such as computing services, storage services, database services, migration services, networking and content delivery services, webhosting, and end-user applications and software).The network access to on-demand standardized information technology resources includes all types of standardized cloud computing services, including computing services, storage services, database services, migration services, networking and content delivery services, webhosting, and end-user applications and software. Cloud computing services are typically provided in a standardized and highly automated way. Standardized cloud computing services may be 'assembled' or configured together for a particular customer (whether by the service provider or by the customer on a self-serve basis). Some cloud computing services, however, involve a high degree of human involvement to customize the service to the needs of a particular client. Such services are not automated digital services and are , therefore, outside the purview of Article 12B. A bespoke cloud

solution involving more than minimal human involvement on behalf of the provider or provider's staff (e.g. engineers or consultants) to create a new computing solution (as opposed to configuring existing solutions) is not considered to be included. To the extent that the human involvement relates only to the configuration of standardized cloud computing products, the integration of standardized cloud computing products into a customer's existing information technology architecture, or ancillary customer support, the human involvement will be considered ancillary to the cloud computing service, which would be covered by this category.

(ix) Finally, standardized online teaching services are those involving the provision of an online education programme provided to an unlimited number of users, which does not require: (a) the live presence of an instructor; or (b) significant customization on behalf of an instructor to a particular user or limited group of users, whether with respect to the curriculum, teaching materials, or feedback provided. This category includes pre-packaged, non-customized education products such as a pre-recorded series of lectures, the content of which is not customized to each individual user (e.g. massive open online courses). Although these services may allow users to discuss the course content with each other on discussion forums within the platform, there is no or only limited interaction with instructors. Another key feature of standardized teaching services is that course work completed by the user is generally not marked by the instructors, but either marked automatically, or by other users. This category does not cover online education products that are customized to a student, or to a limited group of students, and may incorporate certain ancillary elements that are automated (e.g. a prerecorded lecture offered as part of a customized education package; automatically graded assignments accompanying a live-streamed lecture). Such services do not also meet the general definitions of automated digital services, and as such are included in paragraph 59 under the category of customized online teaching services.

59. On the general principles in paragraphs 52 to 56 above and to avoid uncertainty, the expression "automated digital services" does not include:

i. Customized professional services;
ii. Customized online teaching services;
iii. Services providing access to the Internet or to another electronic network;
iv. Online sale of goods and services other than automated digital services; and
v. Revenue from the sale of a physical good, irrespective of network connectivity ("internet of things").

60. The above-listed services are described as follows:

(i) The expression "customized professional services" includes services whether provided individually or as a firm, such as legal, accounting, architecture, engineering, medical professional or financial or other specialized expert consultancy services. Customized professional services are not within the general definition of automated digital services. Although such services may be delivered online (e.g. legal advice sent by email, an architect sending drawings ; or an accountant sending calculations in a spreadsheet), they require customization to each client, through the tailored exercise of professional judgment and bespoke interactions. These services are not automated and require more than minimal human involvement on behalf of the professional individual or firm. They would also not be scalable without additional human involvement.

(ii) Customized online teaching services means live or recorded teaching services delivered

online, where the teacher customizes the service (such as by providing individualized, non-automated feedback and support) to the needs of a student or a limited group of students and the Internet or another electronic network is used as a tool simply for communication between the teacher and the student. This category confirms that customized teaching services delivered online are not within the general definition of automated digital services where the Internet or electronic network is used as a tool simply for communication between the teacher and student. This includes online education packages that are significantly customized to a student, or to a limited group of students, even where certain ancillary elements of the product are automated (e.g. a prerecorded lecture offered as part of a customized education package; automatically graded assignments accompanying a live-streamed, customized lecture). However, a standardized online teaching service with ancillary interaction with an instructor is described in paragraph 58 (ix) above as an automated digital service.

(iii) The expression "Services providing access to the Internet or to another electronic network" applies to the provision of access (i.e. connection, subscription, installation) to the Internet or another electronic network, irrespective of the delivery method, namely over wire, lines, cable, fibre optics, satellite transmission or other means, although there may be change in situation as technology advances. Internet Service Packages in which the Internet access component is an ancillary and subordinate part (i.e. a package that goes beyond mere Internet access comprising various elements (such as content pages containing news, weather or travel information; games fora; web-hosting; access to chat-lines etc.) are not covered by this category. In such cases, the guidance provided in this Commentary for dual category automated digital services and bundled packages would be relevant.

(iv) Online sales of goods and services other than automated digital services involve the sale of a good or service completed through a digital interface where: the digital interface is operated by the provider of the good or service; the main substance of the transaction is the provision of the good or service; and the good or service does not otherwise qualify as an automated digital service. This category applies to sellers that use a digital platform to sell their own non-digital goods and services to customers. While the sale can be transacted over the Internet, these businesses are sellers of non-digital goods and non-digital services, rather than offering a digital service per se. This is the case of online selling of tickets for international transport, profits in respect of which as clarified in paragraph 2 of Article 12B, are covered by Article 8. Applying the general definition of automated digital service, the provision of the intended good / service is not of a type that is automated but requires additional human interventions to make that service available to additional users.

(v) Irrespective of the network connectivity of a physical good, payment for the sale of that physical good is not considered to be covered by Article 12B provided there is no separate identifiable payment for the automated digital service attached to that physical good (either at the time of purchase or a later date). Increasingly, physical goods may be connected to the Internet, or bundled with an online service. Beyond the sale of the physical good, such goods can be additionally monetized with a customer beyond the purchase of the physical good through different payment streams (whether at the outset at the time of purchase or at a later date), and those payment streams are captured by existing categories of automated digital services included in paragraph 6 of Article 12B and paragraph 57 of the Commentary as above. Common examples include: (a) the monetization of data collected from the connected object; (b) online advertising revenue relating to advertisements displayed on the connected object; and (c) the user of the connected object may pay for different types of automated digital services relating to, and / or to be accessed through the connected object. To the extent that these payment streams are separately identifiable from the sale price of the physical good,

the payment for the automated digital service would be captured by Article 12B. Further deliberation is required to address cases where a separate payment stream can be inferred even if not explicitly identified as such. There are certain types of machinery and industrial products that may contain a digital component. For example, monitoring the performance of an engine and providing remote technical support. This will typically require significant human involvement to provide the core function, which is using that information to conduct maintenance and repairs on the machinery. This is related to the operation of the machinery, rather than the service provider separately monetizing that data in an automated way with a third party. This means that the Internet-enabled functionality of the machinery would not meet the general definition of automated digital service in paragraph 5 or any item included in paragraph 6 of Article 12B .There are certain products, known as the "Internet of things", that provide a network of everyday devices, appliances, and other objects equipped with computer chips and sensors that can collect and transmit data through the Internet, which enables additional features of the product to be used. It may be that many consumer goods now contain some software and may in the future be Internet-enabled, and bringing all such items into the scope of automated digital services would be over-broad having regard to the general definition of paragraph 5, given that the sale of a physical good is not an automated digital service because it is not a service, nor is it provided over the Internet or through another electronic network. Treating a portion of Internet of things goods as within the scope of Article 12B may be difficult in practice – as it would require trying to separate out the value of the digital component of the service. Based on the guidance above, the scope of Article 12B would include the revenue from the Internet of things to the extent separately identifiable as in respect of another automated digital service.

61. There may be a situation where a particular kind of automated digital services may wholly or partly fall within the scope of royalty or of technical services covered by Article 12 or by Article 12A respectively. Paragraph 7 of Article 12B provides that Article 12B does not apply to any amounts within the definition of "royalties" in Article 12 or "fees for technical services" in Article 12A . This follows from paragraph 7 of Article 12B. Where, however, some part of the services amongst a bundle of automated digital services fall within definition of royalties or of technical services in Article 12 or 12A respectively, taxation of such part only would be governed by Article 12 or 12A, as the case may be, and for the remaining parts, Article 12B would apply.

62. There may be activities which are not clearly severable. Where a substantial part of the overall activity fulfills the criteria under paragraph 5 of Article 12B and the remaining elements derive significant benefits from their connection to the elements having characteristics under paragraph 5, then the overall service may be regarded as covered under Article 12B. By contrast, where the elements fulfilling the criteria or matching the characteristics under paragraph 5 of Article 12B are merely ancillary or a technical support feature for the rest of the service (for example an automated chat function to screen a user's request as an entry point to the service), and the rest of the service requires human involvement, the overall service shall not be considered as covered under Article 12B.

63. It should be noted that, while Article 12A excludes payments by individuals for services for personal use from the definition of "fees for technical services", paragraph 5 of Article 12B does not make a similar exclusion. In consequence, Article 12B also applies to automated digital services provided to individuals for their personal use. Even though such payments would not normally be deductible by those individuals for tax purposes, it cannot be disregarded that many multinational enterprise groups that rely on digital business models derive a very significant portion of income from the provision of automated digital services generally to individual

consumers. Since, the imposition of tax obligations at source on such payments by individuals under domestic law may be difficult to enforce and might cause compliance problems for individuals consuming automated digital services supplied remotely by non-residents, other mechanisms for collection may be required. Such mechanisms are already in place in some countries.

64. In this sense, domestic legislation in some jurisdictions levying taxes on automated digital services requires non-resident providers to present a tax return where the tax obligation has been self-assessed and subject to examination by the tax administration. Other jurisdictions, instead, have the obligation to determine and pay the tax due by the non-resident provider, to the financial intermediary that individual consumers access to make the payments for the automated digital services involved. Jurisdictions may also apply both mechanisms, triggering the obligation of the financial intermediary only in cases the self-assessment is not submitted.

65. A large minority of members were of the view that payments by individuals for automated digital services for personal use should be specifically excluded from the definition of "income from automated digital services". Such an exclusion is provided for under Article 12A (Fees for Technical Services). Moreover, the imposition of withholding tax obligations on such payments by individuals under domestic law would be difficult to enforce and might cause serious compliance problems for individuals utilizing automated digital services supplied remotely by non-residents. This could be achieved by including the following sentence at the end of paragraph 5: "*The term "income from automated digital services" also does not include payments made by an individual for services for the personal use of the individual*."

Paragraph 7

66. Paragraph 7 of Article 12B provides that the provisions of Article 12B shall not apply if the payments underlying the income from automated digital services qualify as "royalties" or "fees for technical services" under Article 12 or Article 12A as the case may be. It may sometimes be necessary to distinguish between payments in consideration for automated digital services and payments or fees towards technical services in order to determine whether Article 12B or Article 12A is applicable. In other situations, such differentiation may need to be made between payments for automated digital services and payments that constitute royalties so as to determine whether Article 12B or Article 12 is applicable. For this purpose, the principles in the respective Articles, i.e. paragraph 5 of Article 12B, paragraph 3 of Article 12A and paragraph 3 of Article 12 together with the Commentary on the Articles, need to be carefully applied to determine the characterization of the payment. Thereafter the particular Article will take precedence over the other. With respect to a so-called mixed contract, the appropriate course would be to break down, on the basis of information contained in the contract or by means of a reasonable apportionment, the whole amount of the stipulated consideration according to various parts of what is being provided under the contract, and then to apply to each part of it, as so determined, the taxation treatment proper to it.

Paragraph 8

67. This paragraph provides that provisions of paragraphs 1, 2 and 3 of Article 12B do not apply to income from automated digital services if the person which provides the services has a permanent establishment or fixed base in the State in which the income arises and the income is effectively connected with that permanent establishment or fixed base. In this regard, paragraph 8 is similar to paragraph 4 of each of Articles 10, 11, 12 and 12A. Thus, if a resident of one Contracting State provides automated digital services through a permanent establishment or fixed

base located in the other Contracting State, the payment received for those services will be taxable by the State in which the permanent establishment or fixed base is located in accordance with Article 7 or Article 14, rather than in accordance with Article 12B.

68. Since Article 7 of the United Nations Model Convention adopts a limited force-of-attraction rule, which expands the range of income that may be taxed as business profits, paragraph 8 also makes paragraphs 1, 2 and 3 inapplicable if the income from automated digital services is effectively connected with business activities in the State in which the income arises that are of the same or similar kind as those effected through the permanent establishment

69. Like paragraphs of Articles 10, 11,12 and 12A where the expression "effectively connected" is used, paragraph 7 of Article 12B also does not define the meaning of the expression "effectively connected." As a result, whether income from automated digital services is effectively connected with a permanent establishment, fixed base or business activities similar to those carried on through a permanent establishment must be determined on the basis of all the relevant facts and circumstances of each case. In general, income from automated digital services would be considered to be effectively connected with a permanent establishment or fixed base if the automated digital services are closely related to or connected with the permanent establishment or fixed base or if the business activities are similar to those carried out through the permanent establishment. Also, income from automated digital services would be effectively connected with business activities referred to in clause (c) of paragraph 1 of Article 7 where the automated digital services are provided by an enterprise as part of that enterprise's business activities carried on in a Contracting State where a permanent establishment of that enterprise is situated and these activities are of the same or similar kind as the business activities performed through that permanent establishment.

70. Where paragraph 8 applies, payments in consideration for automated digital services are taxable by the State in which the income arises as part of the profits attributable to the permanent establishment in accordance with Article 7 or the income attributable to the fixed base in accordance with Article 14. Thus, paragraph 8 relieves the State in which the income from automated digital services arises from the limitations on its taxing rights imposed by Article 12B. Where Article 7 applies as a result of the application of paragraph 8, most countries consider that the State in which the permanent establishment is located is allowed to tax only the net profits from the automated digital services attributable to the permanent establishment. Article 7 does not preclude taxation of business profits attributable to a permanent establishment on a gross basis, but a Contracting State must not discriminate against residents of the other State in violation of paragraph 3 of Article 24 (Non-discrimination). Similarly, where Article 14 applies, most countries consider that the State in which the fixed base is located is allowed to tax only the net income derived from the automated digital services. However, it may be useful for Contracting States to clarify these issues during the negotiation of the treaty.

Paragraphs 9 and 10

71. Paragraph 9 lays down the principle that income from automated digital services arises in a Contracting State if the underlying payments for such income are made by a resident of that State or if the person making the underlying payments for the automated digital services, has in the Contracting State a permanent establishment or a fixed base in connection with which the obligation to make the payments was incurred, and such payments are borne by the permanent establishment or fixed base. It is not necessary for the services to be provided in the Contracting State in which the payer is resident or has a permanent establishment or fixed base. Whether a

person is a resident of a Contracting State for purposes of Article 12B is determined in accordance with the provisions of Article 4 of the Convention.

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

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

74. Even when a service is covered by the definition of “automated digital service” provided in paragraph 5, for Article 12B to apply, the income from such automated digital service has to arise in a Contracting State according to paragraph 9, i.e. a payment has to be made in consideration for such automated digital service by a resident of that Contracting State or by a permanent establishment or a fixed base in that Contracting State. There may be cases where an automated digital service, for instance, a search engine or a social platform service, is provided to users for free. In such situation, no taxing right is allocated to jurisdictions where automated digital services are provided to users located therein who do not make payments in consideration for such services. Also, it cannot be argued that the voluntary or involuntary provision of data by users, as a condition to access the social platform or search engine, or any other automated digital service, has to be considered as a type of payment in consideration for the automated digital service.

75. The sourcing rule in paragraph 8 of Article 12B operates on the basis of ”payment” and not on the basis of location of users. For example, where an enterprise of State A provides search engine services to users that are located in State B without requiring any payment in consideration for such services, it collects data regarding those users’ profile. Such information allows that enterprise to provide online advertising services to a person resident in State C that is interested in reaching potential consumers of its own services and products in State B. Therefore, the enterprise of State A receives payments made by the person resident in State C to target advertisements to specific potential consumers among the users of the search engine services that the enterprise in State A provides for free to residents of State B. By virtue of Article 12B of the tax treaty between State A and State C, State C may tax the income derived by the enterprise of State A from the provision of the online advertising services that is, the payments received from the resident in State C. However, Article 12B of the tax treaty between States A and State B does not allocate any taxing right to State B, merely due to the location of users therein, unless payments are made by such users, who are residents of State B, to the provider of automated digital services which is a resident in State A.

76. Paragraph 9 is subject to paragraph 10, which provides an exception to the source rule in paragraph 9. Paragraph 10 deems payments in consideration for automated digital services made by a resident of a Contracting State not to arise in that State where that resident (the payer) carries

on business through a permanent establishment in the other Contracting State or performs independent personal services through a fixed base in the other Contracting State and the underlying payments for automated digital services are borne by that permanent establishment or fixed base. As a result, in these circumstances, the Contracting State in which the payer is resident is not allowed to tax the payments for automated digital services under paragraphs 2 or 3.

77. The phrase “borne by” must be interpreted in the light of the underlying purpose of paragraphs 9 and 10, which is to provide source rules for income from automated digital services. A Contracting State is entitled to tax income from automated digital services under paragraph 2 or 3 only if the income arises in that State. The basic source rule in paragraph 9 is that income from automated digital services arises in a Contracting State if the payer is a resident of that State or the payer has a permanent establishment or fixed base in that Contracting State and the payments in consideration for automated digital services are borne by that permanent establishment or fixed base. However, the basic rule is limited by the deeming rule in paragraph 10 where the payer is a resident of a Contracting State but the payments in consideration for automated digital services are borne by a permanent establishment or fixed base that the payer has in the other Contracting State.

78. Where underlying payments in consideration for automated digital services are incurred for the purpose of a business carried on through a permanent establishment or for the purpose of independent personal services performed through a fixed base, those payments will usually qualify for deduction in computing the profits attributable to the permanent establishment under Article 7 or the income attributable to the fixed base under Article 14. The deductibility of the automated digital service payments provides an objective standard for determining that the payments have a close economic connection to the State in which the permanent establishment or fixed base is situated.

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

Paragraph 11

80. The purpose of paragraph 11 is to restrict the operation of the provisions concerning the taxation of income from automated digital services in cases where, by reason of a special relationship between the payer and the beneficial owner of the income or between both of them and some other person, the amount of the payments underlying such income exceeds the amount that would have been agreed upon by the payer and the beneficial owner if they had stipulated at arm’s length. Paragraph 11 provides that in such a case the provisions of the Article apply only to the last-mentioned amount and the excess part of the payments underlying the income from automated digital services would remain taxable according to the laws of the two Contracting States, due regard being had to the other provisions of the Convention.

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

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

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

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

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