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OECD Countries Agree on the Interpretation of a Key Condition for Taxing Profits from Foreign E-Commerce Business

Members of the OECD's Committee on Fiscal Affairs, the main forum for multilateral discussion of tax matters between the world's most developed countries, have reached a consensus on how to apply one of the conditions that, under tax treaties, determine a country's right to tax profits from electronic commerce.

The consensus relates to the interpretation, as regards e-commerce, of the conditions under which business activities of an enterprise in a given country are or are not carried out through a permanent establishment, the basic criterion that determines the country's right to tax. The main elements of the consensus are as follows:

- a web site cannot, in itself, constitute a permanent establishment;
- a web site-hosting arrangement typically does not result in a permanent establishment for the enterprise that carries on business through that web site;
- an Internet Service Provider will not, except in very unusual circumstances, constitute a dependent agent of another enterprise so as to constitute a permanent establishment of that enterprise;
- while a place where computer equipment, such as a server, is located may in certain circumstances constitute a permanent establishment, this requires that the functions performed at that place be significant as well as an essential or core part of the business activity of the enterprise.

The consensus is reflected in amendments to the Commentary on the OECD Model Tax Convention which were recently adopted by the Committee on Fiscal Affairs. These amendments will help both companies and tax authorities determine how to apply the permanent establishment definition in relation to e-commerce. As such, they mark an important clarification in the fiscal environment for e-commerce, which is likely to assist in its continued growth. These amendments are available on the OECD's website at: http://www.oecd.org/daf/fa/material/mat_07.htm#material_final

The OECD Model Tax Convention, first published in 1963 and regularly updated since then, is the basic reference manual used by both OECD and non-OECD countries for the negotiation, application and interpretation of bilateral tax treaties co-ordinating their direct tax systems. The latest amendments to it build upon drafts that were released for public comment in October 1999 and March 2000. Extensive comments were received both from OECD countries and from countries outside the OECD area, and these were taken into account.

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At the same time, the Committee was careful to ensure that interpretation of the conditions underlying the current treaty definition of permanent establishment remain fully consistent in the case of e-commerce with the views of OECD countries on application of these conditions to more traditional business operations. Comments received from non-OECD countries indicate that the amendments reflect interpretations that have wide support among these countries as well.

The amendments deal exclusively with the definition of permanent establishment as it currently appears in Article 5 of the OECD Model Tax Convention. A Technical Advisory Group (TAG) on Monitoring the Application of Existing Treaty Norms for the Taxation of Business Profits in the Context of Electronic Commerce, set up by the Committee on Fiscal Affairs in January 1999, is still reviewing the broader implications of e-commerce for the Convention. Among other things, this group, which brings together representatives of both OECD and non-OECD countries as well as of the business community, has been asked to express a view on whether changes are needed in the rules for taxing business profits of foreign e-commerce businesses, including as regards the permanent establishment concept. Its findings will form the basis for a future decision by the Committee on Fiscal Affairs.

Additional background information on the OECD's Model Tax Convention and on the work of the OECD in the area of taxation and e-commerce can be found on <http://www.oecd.org/daf/fa/treaties/treaty.htm> and on http://www.oecd.org/daf/fa/e_com/e_com.htm.

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