English

Committee of Experts on International
Cooperation in Tax Matters
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electronic digital format. However, the SNA 2008 does not clearly classify knowledge capturing products into goods or services.[7]

The term "service" is also used in the GATS of the WTO. However, the GATS does not directly define the term "service" although this term is normally considered as the cornerstone of the GATS. There are four modes of supply of services in the GATS, i.e., cross-border supply, consumption aboard, commercial presence and presence of natural person, which ***"are essentially defined on the basis of the origin of the service supplier and consumer, and the degree and type of territorial presence which they have at the moment the service is delivered."*** [8] Such modes of supply ensure that the GATS may apply only to the supply of services with international elements.[9]

With the development of electronic commerce, these four modes of supply have exposed their noticeable shortcomings resulted from the territorial factors used as a main standard for classifying the mode of supply of services in the GATS. A "Progress Report" adopted by the Council for Trade in Services on 19 July 1999 concerning the "Work Programme on Electronic Commerce" already recognized that "there was particular difficulty" in making a distinction between supply under modes 1 and 2 ("cross-border supply" and "consumption abroad," respectively). In the United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services Case in 2004, this "particular difficulty" was mentioned by the report of the Panel.[10]

Therefore, it seems to be questionable to apply the definition of the term "service" in the GATS to the international tax regime. Instead, goods, services and knowledge mentioned in the SNA 2008 appear to have stronger relevance to the definition and classification of services in the international tax regime. It seems to the author that all services, whether change-effecting services or margin services, could be mainly classified, on the basis of the combination with the goods (physical objects) and knowledge (information), into two types: one is services combined with physical objects, the other is services combined with knowledge (information).

Further, in the economic life physical objects and knowledge (information) may sometimes be as inventory for sale, and sometimes be as capital assets for being productive tools. Therefore, for services combined with physical objects and services combined with knowledge (information), there may be different modes of supply. Services may be supplied along with the delivery of the inventory (including physical objects and knowledge). For example, when buying foods in a supermarket the supply of retail services of foods and the transfer of the ownership of foods from the seller to the buyer is combined together and completed at same time. Services may also be separately and independently performed to consumers by the supplier with his/her physical capital assets (physical objects) or intangible capital assets (knowledge such as technology, information, or computer software, etc.). For example, for a taxi driver, his/her own or rented taxi is his/her capital assets for the supply of transportation services, passengers only enjoy transportation services supplied by the driver

[7] Ibid.
[8]

E/C.18/2014/CRP.

information products that the user needs, whereas, on the other hand, the software collects, storages and analyzes, through the behind platform and for other purposes, the user's personal data which is left voluntarily or compulsorily by the users during their using the data-analyzing software. Generally, these user's personal data is collected by the data-analyzing software without any payment, and the users are thus called by some commentators as the "free labor". [11]

3. Assessment of the response of the UN Model to the electronic commerce

3.1 Overview of the existing provisions of the UN Model dealing with services

The current international tax regime has been established under this structure: with respect to income derived from international trade and investment, the resident country exercises personal taxation whereas the source country exercises territorial taxation. Based on such prerequisite, tax treaty rules classify income into different types and share tax right between the residence and source country for each type of income respectively. Essentially the scope of territorial taxation by the source country is restricted by the tax treaty rules. Therefore, if there may still be double taxation resulted from the overlap of tax right of both countries, the residence country is responsible for giving taxpayer tax credit or exemption for eliminating double taxation. The design of the existing provisions of the UN and OECD Model follows this basic structure.

The existing provisions of the UN Model dealing with services, as indicated by Mr. Brain Arnold, adopt different underlying principles for different types of services, and ha[ve] fundamental inconsistencies in the tax treatment to income derived from various types of services.[12] The same approach also exists in the OECD Model, even in all existing tax treaties. This phenomenon perhaps represents the current international consensus in the tax treatment to income derived from various types of services. As the treaty negotiation is based on the voluntary basis, different underlying principles for different types of services might be desirable for tax treaty partners, through which the goal of fairly sharing international tax interests between tax treaty partners may be possibly realized. Therefore, fundamental inconsistencies in the tax treatment to income derived from various types of services will continue in the future.

3.2 The response of the UN Model to the electronic commerce

With the development of digital information and network technology, electronic commerce, especially trade in cyber-based services, challenges the current international tax regime, including the UN and OECD Model. Firstly, different from traditional which shall be conducted wholly or partially on the physical basis, electronic commerce many be conducted and completed wholly or partially in the cyberspace virtually and automatically. That means, it is not necessary for the taxpayer to have any form of physical presence in the source country for carrying on its business, especially trade in cyber-based services. Therefore, existing international tax rules which restrict territorial taxation of the source country with

[11] Pierre Collin, Nicolas Colin, Task Force on Taxation of the Digital Economy, Report to the Minister for the Economy and Finance, the Minister for Industrial Recovery, the Minister Delegate for the Budget and the Minister Delegate for Small and Medium-Sized Enterprises, Innovation and the Digital Economy, Jan. 2013. This report was asked by and has been submitted to the French Government.

[12] Brain Arnold, Note on the Taxation of Services under the United Nations Model Tax Convention, UN E/C.18/2010/CRP.7, 11 October, 2010, at 1.2.1

currently confines royalties to the payment involving the commercial exploitation of the digitalized information in the electronic commerce, and treats the payment involving the transmission of the digitalized information as business profits, according to the rationale of the difference between the underlying copyright in the program and software which incorporates a copy of copyrighted program. With same underlying rationale on the characterization of the software payment, the Commentary indicates that the income derived from cross border transactions involving cyber-based services will be characterized as business profits. Second, the Commentary indicates that a computer sever itself, not a website, may constitute a permanent establishment if it performs integral aspects of a cross border transaction, is owned or leased by the non-resident enterprise and is fixed in a location for a sufficient period of time.

In 2011, the relevant paragraphs of the Commentary of the OECD Model mentioned above are reproduced by the Commentary of Article 12 and Article 5 of the UN Model, as a reaction to the development of electronic commerce. However, as observed by many commentators, the changes made by the Commentary of the OECD Model, followed by the Commentary of the UN Model, did not substantially solve the challenges, and actually reflected a very limited and weak political compromise. From the technical point of view, the approach that two Models take has not given sufficient consideration of the following three factors in the digital economy: (1) the fact that there is no necessary forms of physical presence for a taxpayer who carries on its business, including trade in cyber

the developing and developed countries, the provisions of the UN Model have been designed with factors which reflect the general modes and characteristics of international trade and investment between developing and developed countries. This Model takes into account the comprehensive balance between international tax interests enjoyed by countries involved and other social and economic interests arising from international trade and investment between them.[17]

Base on the balance mentioned above, it seems that the revision of the Commentary of the UN Model in 2011 has not effectively solved the predicament that the source taxation of source countries would be significantly restricted if these countries adopt the existing provisions of the UN Model dealing with services and apply them in electronic commerce. With the expansion of the cross border trade in cyber-based services, the prospective result of the restriction of the source taxation is that the tax interests of source countries would be rapidly reduced and the fair share of the international tax interests arising from cross border electronic commerce between residence countries and source countries could not be effectively achieved.

Methodologically, in 2011, in order to keep up with the development of digital economy, the UN Committee of Experts on International Cooperation in Tax Matters applied interpretation-changing method, i.e., making the revision of the Commentary of the UN Model, rather than changing wordings of relevant provisions of the UN Model. It seems to the author that, interpretation-changing method has its advantages that could keep the provisions stable with an expansion of the scope of possible meaning of wordings used in the provisions interpreted to maximum extent. However, the interpretation method has its own limitation. It does not work when the possible meaning of wordings used by a tax treaty cannot cover the new facts developed in the real life.

Under the digital economy, interpretation method has not been enough to dealing with the challenges from the electronic commerce because new factors in the digital economy have emerged and not been effectively covered by the wordings of the existing provisions of the UN Model. A notable feature which distinguishes cyber-based services from traditional services is that any form of physical presence of the supplier of cyber-based services in the territory of the consumer countries is not required. The possible meaning of wordings used by the existing provisionactealthN4(niM)1nistused b02 6p5 Tc 0.004 Twoafg-D0(c)4(a).e/(thd b0(a)

rebalance of international tax interests sharing between the supplier countries and consumer countries, the improper unilateral restriction of tax jurisdiction suffered by the source countries should be eliminated, and the relevant revision of the existing provisions of the UN Model dealing with services should be revised according to the characteristic of virtualization in cyber-based services. In other words, the revision will be focused on how to design the reasonable conditions under which source countries may effectively enjoy tax jurisdiction to

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limitation of technology. However, in the digital economy, as mentioned above, the development of network and information digitalization technology has made any form of physical presence unnecessary for the supplier of the cyber-based services in the territory of the consumer countries. Therefore, taking into account the factors of the development of the technology of information, and the factors reflecting the fact of the supply of cyber-based services to consumers located in a contracting state as a substitute for the factors of physical presence in the above-mentioned definition of the term "fees for technical services", the existing separate provision in some treaties dealing with fees for technical services could be used to deal with fees for cyber-based technical services.

In the proposed separate provision dealing with fees for cyber-based technical services, the term "fees for cyber-based technical services" may be defined as "***any consideration for the provision of any managerial, technical or consultancy services by a resident of a contracting state through the network to consumers in the other contracting state, including the provision by such a resident itself or other personnel employed or engaged for such a purpose.***"

In fact, the proposed separate provision dealing with fees for cyber-based technical services has been supported in practice not only by the above-mentioned experiences in some tax treaties dealing with fees for technical services, but also by Article 16 of the UN Model dealing with director's fees and remuneration of top-level managerial officials and Article 16 of the OECD Model dealing with directors' fees. Article 16 of both Models recognize that when a resident of a contracting state as a director or a top-level managerial official of a company situated in the other state provides his/her managerial services to that company, his/her income derived from his/her such services may be taxed in that other state, wherever he/she provides his/her such services. Article 16 of both Models implies that the factors of

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UN or OECD Model based on the respective characteristics of different types of services. Such arrangement for the taxation of services in the UN and OECD Model implies that the principles of the taxation of services in tax treaties are potentially open, and what principles

such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention."

4.2.4 Regarding the website through which an enterprise carries on its business as a virtual permanent establishment

It has been widely discussed that the existing PE concept which was created in the traditional economy and defined with all physical factors is no longer fit to the digital economy. However, substantially, the PE is just a legal form, the purpose of which is to indicate the economic substance as follows: an enterprise of a contracting state has its economic presence in the other contracting state to such extent that the other contracting state's right to tax on the income derived from its economic presence by an enterprise of a contracting state should not be limited.This rationale of the PE concept remains the same whether an enterprise carries on its business in the traditional economy or digital economy. Therefore, the PE concept should not be restricted to its existing physical component factors developed in the traditional economy, but should evolve with the development of the mode of the economy. In this regard, the concept of the virtual permanent establishment (the virtual PE) or the digital permanent establishment (the digital PE) has been proposed for many years, with an intention to indicate the economic presence of an enterprise of a contracting state in the other contracting state in the digital economy.[19] In the concept of the virtual PE, by analogy, the website through which the business of an enterprise is wholly or partly carried on may be regarded as a business place or an agent of the enterprise of a contracting state doing business in the other contracting state.

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Therefore, the proposed provisions dealing with the virtual PE and the proposed provisions dealing with fees for the cyber-based services are alternative, but the proposed provisions dealing with the virtual PE may be introduced in connection with the proposed provisions mentioned in 4.2.1 and 4.2.2. In other words, the residual cyber-based services which may not be dealt with in the proposed provisions mentioned in 4.2.1 and 4.2.2 could be dealt with by the proposed provisions dealing with the virtual PE.

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