


TD 2004/D77 - Income tax: does a resident of a country with which Australia has a Tax Treaty, have a permanent establishment solely from the sale of trading stock through an internet website hosted by an Australian resident internet service provider?

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This document has been finalised by TD 20052.



Draft Taxation Determination

Income tax: does a resident of a country with which Australia has a Tax Treaty, have a permanent establishment solely from the sale of trading stock through an internet website hosted by an Australian resident internet service provider?

Preamble

*This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVA of the **Taxation Administration Act 1953**. It is only final Taxation Determinations that represent authoritative statements by the Australian Taxation Office.*

1. No, where the internet service provider (ISP)¹ is acting as a mere conduit, the Business Profits Article of the relevant Tax Treaty will apply. The non-resident will not, by virtue of the web-site alone, have a permanent establishment (PE) in Australia. The answer in this determination is provided on the basis of the assumptions in paragraph 2. If those assumptions are not fulfilled, the determination will not apply.
2. The following assumptions are made in this determination:
 - (a) that the taxpayer, as a resident of the country with which Australia has a tax treaty, is entitled to the benefits of the relevant treaty;²
 - (b) that the taxpayer does not have a PE in Australia under other parts of the PE definition in the relevant treaty apart from the fixed place of business examples of PEs in the treaty;
 - (c) that the ISP is carrying on a business as an ISP, is dealing at arm's length with the taxpayer and does not provide other services to the taxpayer in addition to the hosting³ arrangement which may give rise to a PE of the taxpayer; and

¹ The *Macquarie Dictionary* (revised 3rd edition) defines Internet Service Provider as a company which provides connection to the Internet, usually for a fee.

² Thus the determination will not apply, for example, if the taxpayer does not qualify under a limitation of benefits article in a treaty or if the taxpayer is a dual resident and dual residents are excluded from the benefits of a treaty.

³ A host is a computer or network running a particular application or service, as defined in Botto, F 2003, *Dictionary of e-business: a definitive guide to technology and business terms*, John Wiley & Sons Ltd, London, p.148

- (d) that any income from the sale is covered by the business profits article of the tax treaty and not some other article.

Domestic law

3. Subsection 6-5(3) of the *Income Tax Assessment Act 1997* (ITAA 1997) provides that the assessable income of a non-resident includes ordinary income derived directly or indirectly from all Australian sources. In some circumstances, income derived by a non-resident from the sale of merchandise to Australian consumers through a web-site hosted by an Australian resident ISP may constitute ordinary income of the non-resident under subsection 6-5(3). The income may also be assessable in Australia under sections 38 to 43 of the *Income Tax Assessment Act 1936* (ITAA 1936), in which case the amount of profit to be included in the non-resident's assessable income is calculated under those provisions and not subsection 6-5(3) of the ITAA 1997.

Application of Tax Treaties

4. Where the tax position involves a resident of a country with which Australia has a Tax Treaty it is necessary to consider the application of the relevant articles in the Tax Treaty. Where there is inconsistency, the terms of the Tax Treaty effectively override those of Australia's domestic tax law. Profits from the sale of trading stock would constitute the profits of an enterprise carried on by a resident of the treaty partner country and would fall under the Business Profits Article.⁴ Under this article, Australia may not tax the business profits derived by an enterprise of the other contracting state unless those business profits are attributable to a permanent establishment situated in Australia through which the enterprise carries on business. Thus, the existence of a permanent establishment is central to the allocation of taxing rights under the Business Profits Article.

Definition of permanent establishment

5. The term 'permanent establishment' is defined in the Permanent Establishment Article⁵ in Australia's Tax Treaties, generally contained in Article 5.⁶ The term is defined in Article 5(1)⁷ to mean a:

fixed place of business through which the business of an enterprise is wholly or partly carried on.

⁴ Subject to modifications, the business profits/permanent establishment principle is common to all of Australia's Tax Treaties and is found in the OECD Model Tax Convention on Income and on Capital (the OECD Model).

⁵ Although there are differences in this article between tax treaties, these are not relevant where the only service provided by the ISP to the non-resident is hosting the web-site of the enterprise.

⁶ See Article 4 of the Singapore and France Agreement, Schedule 5 and 11 of the *ITAA 1953* (Agreements Act); Article 3 of the Japanese Agreement at Schedule 6 of the Agreements Act.

⁷ Article 4(1) of the Singapore and France Agreement, Schedule 5 and 11 of the Agreements Act; Article 3(1) of the Japanese Agreement, Schedule 6 of the Agreements Act.

6. Guidance on the application of this article to web-sites can be found in paragraphs 42.1 to 42.10 of the Commentary on the OECD Model Tax Convention on Income and on Capital (the Commentary).⁸ The Commentary discusses whether the use of computer equipment in electronic commerce operations in a country can constitute a permanent establishment under the Business Profits Article of the OECD Model.

7. A distinction is drawn between computer equipment and the data and software used by, or stored on, that equipment.⁹ A web-site is considered to be a combination of computer software and electronic data. The distinction between the web-site and the server on which the web-site is stored is important when, as in the case under consideration, the enterprise that operates the server is different from the enterprise that carries on business through the web-site. The server on which a web-site is stored is a piece of equipment with a physical location and may constitute a 'fixed place of business' of an enterprise which has that server at its disposal.¹⁰ However, the fact that an enterprise has a certain amount of space on the server of an ISP allocated for it to use to store software and data does not result in the server being at the disposal of the enterprise. The enterprise is not considered to have acquired a place of business by virtue of the hosting arrangements.¹¹

8. Where an ISP is only in the business of providing access to the internet it operates as a mere conduit for the business activities of the non-resident enterprise. The agreement with the ISP would not typically specify which server the web-site will be hosted on and the ISP may change the server used at their discretion. The space used for a specific web-site on the server of the ISP is not at the disposal of the entity that owns the web-site. Thus, the enterprise does not have a fixed place of business in Australia.

9. Article 5(2)¹² of Australia's Tax Treaties contains a list of examples each of which can be regarded as constituting a permanent establishment such as a place of management, an office, a branch, a factory or a workshop, or agricultural, pastoral or forestry property. The web-site being a combination of software and data does not, of itself, fall within the list generally contained in Article 5(2).¹³

⁸ As to the relevance of using the Commentary, see paragraphs 101 to 105 of TR 2001/13.

⁹ Paragraph 42.2 of the Commentary.

¹⁰ Paragraph 42.2 of the Commentary.

¹¹ Paragraph 42.3 of the Commentary.

¹² Article 4(2) of the Singapore and France Agreement, Schedule 5 and 11 of the Agreements Act; Article 3(2) of the Japanese Agreement, Schedule 6 of the Agreements Act.

¹³ Article 4(2)(d) of the Singapore Agreement, Schedule 5 of the Agreements Act, has a substantive departure from other Tax Treaties and specifically includes 'a store or other sales outlet' as constituting a permanent establishment for the purposes of the treaty. A web-site through which goods are sold could be described as a stall in a market for goods. However, the web-site, being non-physical, lacks the requirement of being tangible and thus does not constitute a 'fixed place of business', see paragraph 5.2 of the OECD Model Commentary on Article 5.

10. An enterprise is deemed to have a permanent establishment where a person, other than an agent of an independent status, acts on behalf of an enterprise and habitually exercises an authority to substantially negotiate or conclude contracts on behalf of the enterprise: Article 5(5)¹⁴ of Australia's Tax Treaties.¹⁵ However, under Article 5(6)¹⁶ an enterprise will not be deemed to have a permanent establishment in Australia merely because that enterprise carries on business in Australia through a broker, general commission agent or any other agent of independent status, where the agent is acting in the ordinary course of their business.¹⁷

11. Generally, an ISP will not constitute a permanent establishment by virtue of it being a dependent agent as the ISP is not generally an agent of the enterprise and would lack the authority to conclude, and would not regularly conclude contracts in the name of the non-resident enterprise. The web-site itself does not constitute a dependant agent as it is not a 'person' as defined in Australia's tax treaties. Furthermore, the ISP could constitute an independent agent acting in the ordinary course of their business if, amongst other things, they host web-sites for a number of different enterprises.¹⁸

Conclusion

12. Where the sole presence of an enterprise in Australia is a web-site hosted by an Australian ISP, the enterprise does not have a permanent establishment in Australia, subject to the assumptions in paragraph 2.

Date of effect

13. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

¹⁴ Article 5(6) of the United Kingdom Agreement, Schedule 1 of the Agreements Act; Article 5(4) of the United States Agreement, Schedule 2 of the Agreements Act; Article 5(7) of the New Zealand Agreement, Schedule 4 of the Agreements Act; Article 4(5) of the Singapore Agreement, Schedule 5 of the Agreements Act; Article 3(5) of the Japanese Agreement, Schedule 6 of the Agreements Act; Article 5(4) of the German Agreement, Schedule 9 of the Agreements Act; Article 4(5) of the French Agreement, Schedule 11 of the Agreements Act; Article 5(6) of the Korean Agreement, Schedule 22 of the Agreements Act; Article 5(4) of the Austrian Agreement, Schedule 27 of the Agreements Act; Article 5(4) of the Indonesian Agreement, Schedule 37 of the Agreements Act and Article 5(6) of the Mexican Agreement, Schedule 47 of the Agreements Act.

¹⁵ Although there are substantive differences in this article between Tax Treaties, these are not relevant where the only service provided by the ISP to the non-resident is hosting the web-site of the enterprise.

¹⁶ Article 5(7) of the United Kingdom Agreement, Schedule 1 of the Agreements Act; Article 5(5) of United States Agreement, Schedule 2 of the Agreements Act; Article 5(8) of the New Zealand Agreement, Schedule 4 of the Agreements Act; Article 4(6) of the Singapore Agreement, Schedule 5 of the Agreements Act; Article 3(6) of the Japanese Agreement, Schedule 6 of the Agreements Act; Article 5(5) of the German Agreement, Schedule 9 of the Agreements Act; Article 4(6) of French Agreement, Schedule 11 of the Agreements Act; Article 5(7) of the Korean Agreement, Schedule 22 of the Agreements Act; Article 5(5) of the Austrian Agreement, Schedule 27 of the Agreements Act; Article 5(7) of the Sri Lankan Agreement, Schedule 31 of the Agreements Act; Article 5(5) of the Indonesian Agreement, Schedule 37 of the Agreements Act and Article 5(7) of the Mexican Agreement, Schedule 47 of the Agreements Act.

¹⁷ In a number of the Tax Treaties an agent will not be an independent agent if its activities are devoted 'wholly or almost wholly' on behalf of the enterprise (Tax Treaty with China) or the activities are carried on 'wholly or principally' on behalf of the enterprise (Tax Treaties with India and Indonesia). This provision is not applicable as the ISP does not in the first instance constitute a dependent agent. In addition, it would not be relevant where the ISP hosts web-sites for a number of clients to the extent that the ISP is legally and economically independent of the non-resident.

¹⁸ Paragraph 42.10 of the Commentary.

Your comments

14. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date.

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Commissioner of Taxation

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Previous draft:

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Related Rulings/Determinations:

TR 92/20; TR 2001/13

Subject references:

- commercial website
- electronic commerce
- internet service provider
- non-resident entities
- permanent establishment

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1936 38
- ITAA 1936 39
- ITAA 1936 40
- ITAA 1936 41
- ITAA 1936 42
- ITAA 1936 43
- ITAA 1997 6-5(3)
- International Tax Agreements Act 1953 Sch 1
- International Tax Agreements Act 1953 Sch 2
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- Macquarie Dictionary, Revised 3rd Edition
- OECD Model Tax Convention on Income
and on Capital January 2003 Condensed
version

ATO references

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