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List of Abbreviations

ACI	Amazon.com, Inc.
AEHT	Amazon Europe Holding Technologies
AEU	Amazon EU Sarl
Art(s)	Article(s)
ATAD	Anti-Tax Avoidance Directive
BEPS	Base erosion and profit shifting
BRICS	Brazil, Russia, India, China, South Africa
CCTB	Common Corporate Tax Base
CCCTB	Common Consolidated Corporate Tax Base
CFC	Controlled foreign company
CHF	Swiss franc
CNY	Chinese Renminbi Yuan
CSA	Cost sharing arrangement
CUT	Comparable uncontrolled transaction
DCF	Discounted cash flow
DPT	Diverted profits tax
DSM	Digital Single Market
ECJ	European Court of Justice
EU	European Union
EUR	Euro
G20	Group of Twenty (19 countries plus the European Union)
GAAR	General anti-abuse rule
GATS	General Agreement on Trade and Services
GATT	General Agreement on Tariffs and Trade
GBP	British pound sterling
HRMC	Her Majesty's Revenue and Customs
IBFD	International Bureau of Fiscal Documentation
ICT	Information and communication technology
IDC(s)	Intangible development cost(s)
IP	Intellectual property
IRC	Internal Revenue Code
IRD	Interest and Royalties Directive

IRS	Internal Revenue Service
MAU	Monthly active users
MLI	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting/ Multilateral Anti-BEPS Convention
MNE(s)	Multinational enterprise(s)
MS	Member State(s) of the European Union
MTC	Model Tax Convention
OECD	Organization for Economic Co-operation and Development
Para(s)	Paragraph(s)
PE(s)	Permanent establishment(s)
P(p)	Page(s)
PSD	Parent-Subsidiary Directive
S(s)	Section(s)
Sarl	Société à responsabilité limitée/limited liability company
SME(s)	Small and medium-sized enterprise(s)
TFDE	Task Force on the Digital Economy
TFEU	Treaty on the Functioning of the European Union
UK	United Kingdom
US	United States of America
USD	US dollar

1. Introduction

Is it fair that the old-fashioned bookstore can be taxed, but not the digital store or e-book shop that offers its book downloading services online? Is it not the same product being sold?

Today's world of business consists of multinational companies, which cross borders to explore commercial opportunities around the globe. Substantial energy is devoted to reducing or even avoiding tax. This is so, amongst others, because multinational enterprises (MNEs) are under pressure from public stock markets and private equity fund investors, making them treat tax like any other cost of business which necessarily must be reduced.[1] Amazon is one of these multinational companies operating digitally around the globe. Amazon's aim is to become the most customer-centric company offering their customers the greatest selection at the lowest price. The business expanded from net sales of approximately 15 million dollar in its first year to 178 billion dollar in 2017.[2]

International profit shifting and base erosion envisaged by MNEs would be ineffective without countries offering preferential tax regimes in the first place. Particularly, patent boxes have become fashionable throughout the European Union (EU).[3] Moreover, the ownership of intellectual property (IP) can be transferred to jurisdictions with advantageous IP regimes and low tax rates. The transfer often occurs at a low price without triggering transfer pricing adjustment as these intangibles are very difficult to evaluate. Licensing and sublicensing of IP can often be used to erode the tax base in the market and even in an intermediate jurisdiction.[4] In particular, the digital economy encompasses all businesses, which rely on modern developments in information and communication technology (ICT). The rise and spread of the industry has affected all sectors of the economy and can, therefore, no longer be described as being separate of

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[1] Hugh Ault, Wolfgang Schoen and Stephen Shay, 'Base Erosion and Profit Shifting: A Roadmap for Reform' (2014) 68 Bulletin for International Taxation, p 276.

[2] *Amazon.com, Inc. & Subsidiaries v Commissioner of Internal Revenue*, Petition (2012) Docket No. 31197-12, p 5; Statista, 'Net sales revenue of Amazon from 2004 to 2017' (2018) <https://www.statista.com/statistics/266282/annual-net-revenue-of-amazoncom/> accessed 20 June 2018.

[3] Hugh Ault, Wolfgang Schoen and Stephen Shay, 'Base Erosion and Profit Shifting: A Roadmap for Reform' (2014) 68 Bulletin for International Taxation, p 276.

[4] Joachim Englisch, 'BEPS Action 1: Digital Economy – EU Law Implications' (2015) British Tax Review, p 3.

the mainstream economy as it is increasingly becoming the economy itself.[5] Digitalization is a growing phenomenon of our modern economy. However, the tax framework in place today was designed for the traditional economy and is unable to capture activities, which are increasingly based on intangible assets and data. International profit taxation systems are not keeping up with the pace of this change. Hence, multinational enterprises are engaged in aggressive structuring of their business, taking advantage of the distortion between the business model and existing international tax rules and tax avoidance schemes. Unilateral measures in patchwork form adopted by states in order to address this problem threaten to create new obstacles and loopholes in the EU Single Market, but also on the worldwide market.[6] Thus, the first focus should be on pushing for a fundamental reform of international tax rules, as was done by the Organization for Economic Co-operation and Development (OECD). The OECD has identified and addressed tax challenges caused by the digital economy through its base erosion and profit shifting (BEPS) project. The reasons for intervention include the loss of revenue together with higher compliance costs faced by many governments, which undermines the integrity of the tax system and harms fair competition between enterprises.[7] Base erosion refers to the reduction of companies and their amount of profits to be taxed in a country. Often this is due to the transfer of intellectual property to another country, where royalties will be paid. Profit shifting entails aggressive tax planning and the relocation to low tax countries to prevent the profits from being taxed at a higher rate or from being taxed at all.[8]

First and foremost, the BEPS Action Plan proposes solutions to tax challenges occurring due to the digital economy (Action 1). Action 7, in return, calls for a review of the definition and qualification of a permanent establishment to prevent the use of tax avoidance strategies to circumvent this status. The cross-border dissemination of assets and the fragmentation of activities through treaty shopping allow multinational digital companies to avoid the setting up of permanent establishments (PEs), and thus taxation. The main part of their profits is attributed to jurisdictions with favorable tax regimes, in our case Luxembourg. The existence of PEs gives rise to several tax effects. The most

[5] Ibid, p 2.
[6] European Commission, 'Taxation: Commission sets out path towards fair taxation of the Digital Economy' (Press release 2017), p 1.
[7] OECD, 'Action Plan on Base Erosion and Profit Shifting' (OECD Publishing 2013), p 8 <https://www.oecd.org/ctp/BEPSActionPlan.pdf> accessed 20 June 2018.
[8] Angharad Miller and Lynne Oats, *Principles of International Taxation* (4th edn, Bloomsbury 2014), p 545; Swapneshwar Goutam, 'Critical account of the OECD's Action Plan on Base Erosion and Profit Shifting' (2014) 8 Madras Law Journal 287, p 2.

important one is that the concept, as found in international tax treaties, is decisive for determining a non-resident enterprise's tax obligation for unincorporated business activities with economic allegiance to more than one country.[9] Corporate profits are taxed in the source state where a sufficient taxable nexus between economic activities and the state is established. Hence, a certain degree of economic and business activity has to take place there.[10] It is necessary to be able to preserve the tax neutrality between the source and the residence state. These days, it is possible for businesses to supply markets internationally without any need for a local presence, physically or legally. In the world of multinationals, intangibles and the Internet, profits can be generated virtually.[11] Similarly, the European Union tries and continues to push for a comprehensive revision of global tax rules to meet the new realities.

This research paper will discuss the direct taxation difficulties raised by the phenomenon of digital economy, using the example of Amazon established in Luxembourg, and the solutions pursued by the BEPS Action Plan and to some extent by the EU. It argues that several modifications and improvements have been made on an international and European level, but that likewise alternatives are available, which would achieve an even greater harmonization. The research is confined to an examination of the question *'Within what ways, if any, can the proposed changes to the OECD model tax convention in Action 1 and Action 7 counter the circumvention of the PE status by digital companies, such as Amazon?*'. The aim of this thesis is to clarify in how far, according to BEPS Action 1 and Action 7, the amendments to Article 5 of the OECD Model Tax Convention (MTC) can counter the issue of artificial avoidance of the PE status. By doing so, the paper reveals not only the problems related to PEs, but is concerned with the digital economy in general. It will become clear that other methods than proposed by the OECD are in fact available and might even be more successful. Hence, this research project is timely and considerable in significance. The research of the thesis is conducted in three different parts. The first one includes a case study, which evaluates the relevant tax situation and structure of Amazon in Luxembourg. The

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[9] Tan Ching Kee and Henry Syrett, 'Impact of OECD BEPS Action 7 proposals on modification of Articles 5(4), 5(5) and 5(6) of OECD Model Convention – An evaluation of Action 7 on the future of intra-group transactions and business models of MNEs in their cross-border investments' (2017) 5 SMU School of Accountancy Research Paper Series 2, p 4.
[10] Ibid, p 6.
[11] Maarten de Wilde, 'Tax jurisdiction in a digitalizing economy; why 'online profits' are so hard to pin down' (2015) Intertax 12, p 2.

second part being an examination of the development of doing business in the digital era and the proposed changes in Action 1 and Action 7, will deal specifically with the issue of PEs and how the artificial avoidance thereof can be counteracted. Both actions will be explored in this thesis, as they relate one to another. European Union law notions will be taken into account as well. Lastly, the third part deals with concepts and methods, which constitute and provide alternative solutions to the problems and is thus, a more hypothetical analysis. Hence, a rather doctrinal and reform-oriented research methodology is applied. The thesis will only focus on the area of direct taxation and does neither extensively deal with transfer pricing issues. It is based on research until May 31, 2018 and, therefore, consideration is only taken of material published up to this date.

The thesis is divided into five chapters. Chapter 2 takes up how Amazon planned to establish a European headquarter in Luxembourg and did so by implementing its Project Goldcrest, through which large amounts of tax were bypassed in the United States (US). Moreover, another affair involving Amazon in the UK reiterated the importance of the concept of permanent establishments when it comes to digital businesses. The chapter likewise deals with state aid investigations in the European Union (EU) against the online retail giant, where the European Commission suspects Luxembourg of having granted unfair tax advantages to the company. Next, in chapter 3, the paper takes a closer look at the phenomenon of digital economy, how businesses operating in this market avoid taxation and the solutions proposed to tackle base erosion and profit shifting by the OECD in its Action Plan (Action 1). Chapter 4 continues to analyze the particular problems and proposals for improvement brought forward by the OECD with regards to permanent establishments (Action 7). An additional chapter 5 illustrates the measures that have been taken so far by the EU in implementing the BEPS project and in addressing the issue of tax avoidance and PEs. Finally, the last chapter evaluates alternative concepts to the notion of PE.

2. Case study: Amazon Luxembourg

Today's Internet technology makes retailing a more competitive business than ever before. The Internet enables consumers to compare prices and buy at the lowest one. Hence, competition is literally one click away. Price transparency combined with constant innovation is essential to survive in such competitive market. It is exactly this industry, in which Amazon operates. Amazon is an online retailer without a traditional brick-and-mortar store, but rather selling products exclusively through Amazon.com.[12] One of Amazon's early business goals was to achieve a critical size as fast as possible. It did so by choosing the expedient path.[13] A key factor driving innovation for any company active in the online business is the need to reduce latency. Frustrated customers tend to abandon the page they are viewing or leave the website altogether. Next to this, customer data protection and the prevention of fraud become more and more important.[14] Because the online retail environment is changing so rapidly, Amazon believed it was impossible to anticipate technological advances more than three years away.[15] In order to remain one of the key players in this business, Amazon decided to completely restructure and resettle its business (see Annex A).

As a result, Amazon was recently a party to court proceedings in the US, where it successfully defended itself against the IRS. Similarly, the company faced negative headlines in the UK, where the operation of Amazon's warehouse activities led to the assumption of a circumvention of the PE rules. As the crowning glory, the state of Luxembourg was the target of state aid investigations initiated by the European Commission due to Amazon's restructuring operations.

2.1. Amazon's tax dispute with the US Internal Revenue Service

Amazon is a Delaware corporation, founded in 1994, with its principal place of business in Seattle, Washington. It operates retail websites and offers programs for third parties to sell products on its websites. Amazon.com, Inc. (ACI) is the common parent of Amazon US and numerous foreign subsidiaries.[16] The European subsidiaries were wholly owned by Amazon US and provided it with retail support, storage facilities, back-office support and local financial management services.[17] The European retail business was exclusively conducted through the websites Amazon.co.uk, Amazon.de and Amazon.fr.[18] In the early 2000's, Amazon began to investigate the creation of a

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[12] *Amazon.com, Inc. & Subsidiaries v Commissioner of Internal Revenue* [2017] 148 T.C. No.8 (*Amazon v IRS*), p 10.
[13] Ibid, pp 28-30.
[14] Ibid, p 31.
[15] Ibid, p 32.
[16] Ibid, p 10.
[17] Ibid, p 17.
[18] *Amazon.com, Inc. & Subsidiaries v Commissioner of Internal Revenue*, Stipulation for Trial – Goldcrest Facts (2014) Docket No. 31197-12, p 6.

centralized European headquarter. Thereafter, Amazon set up operations in Luxembourg to radically reshape its tax structure by using a complex patchwork of subsidiaries.[19]

Amazon intended to avoid creating a US permanent establishment, by prohibiting European personnel to sign contracts or take business decisions on behalf of Amazon US. Additionally, it was well aware of the significantly lower effective marginal rate of corporate income tax in Luxembourg.[20] The following section will demonstrate the different measures Amazon pursued to enable such restructuring and relocation to Luxembourg.

2.1.1. Project Goldcrest

Amazon decided to establish European headquarters and eventually opted for Luxembourg as location. Amazon's intention was to transfer all intangible assets necessary to operate the European website businesses from Amazon US to this subsidiary. In addition, the major part of the income from European businesses would be taxed in Luxembourg at low rates. In pursuit of these goals, Amazon successfully negotiated a tax agreement with the government of Luxembourg.[21]

From 2004 until 2006, Amazon undertook a series of transactions to implement this plan, commonly referred to as Project Goldcrest.[22] Initially, Amazon US formed Amazon Europe Holding Technologies (AEHT), the Luxembourg headquarters pass-through entity serving as the IP holding company for all European businesses. Amazon EU Sarl (AEU), a taxable Luxembourg entity, was established to carry out the EU website businesses. After restructuring, the Amazon IP was licensed from AEHT to AEU in return of royalties.[23] Numerous subsidiaries were created to perform various functions in light of the European businesses (collectively, Amazon Luxembourg). As a next step, Amazon effected a restructuring, and thus completed several transactions. Through a cost sharing arrangement (CSA), Amazon US and AEHT agreed to share the costs of research, development, marketing and other activities related to Amazon's intellectual property. AEHT would assist by way of financial contribution and would

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[19] Simon Marks, 'How Amazon saved billions in taxes' (Newsweek 2016) <http://www.newsweek.com/behind-amazons-tax-strategy-494325> accessed 20 June 2018.

[20] *Amazon v IRS*, p 20.

[21] Ibid, pp 20-21; note: Luxembourg tax laws include the possibility to request an advance tax decision in para 29a of the General Tax Law and provide for a procedural framework for tax ruling requests (décisions anticipées) with the grand-ducal regulation of 23 December 2014.

[22] Note: ‚Goldcrest' refers to Luxembourg's national bird.

[23] Internal Revenue Service, 'Explanation of Items' (2005 & 2006) Form 886A, pp 2-3.

pay Amazon US for its share of subsequently intangible development costs (IDCs). Moreover, Amazon US and AEHT entered into a license agreement, in which AEHT was granted the right to use Amazon's intellectual property. In a separate assignment agreement, the parties agreed on the right of AEHT to use Amazon intellectual property not covered by the license agreement, such as customer data, trademarks and domain names. As consideration for the transfer of the intangibles, the subsidiary made a 254 million dollar buy-in payment. Furthermore, Amazon Luxembourg acquired all of the stock of the European subsidiaries via tax-free reorganizations, and thus became the ultimate owner of all their property and the employer of all their employees. Various assets including inventory, accounts, vendor contracts and certain other contracts were equally transferred to Amazon Luxembourg. Lastly, under the Four-Party Agreement, the European subsidiaries exclusively assigned to AEHT certain intellectual property in exchange for five million dollar (see Annex B).[24]

After April 30, 2006, Amazon Luxembourg reported all of the income and expenses connected with European businesses, for US tax purposes. It was by no means a mere shell company as it played an important role in developing and expanding Amazon's existing business predominantly in Germany, in the UK and in France, but equally in other European countries. Within a seven-year period, AEHT launched 11 new product categories, which contributed to rapidly growing revenues during this period.[25] As the company's secret business success was revealed, the landmark case between the US tax authorities and Amazon could have resulted in a tremendous fine, which it did not.

2.1.2. *Amazon.com, Inc. v Commissioner of Internal Revenue*

The US Internal Revenue Service (IRS) determined deficiencies in the petitioner's federal income tax, following the series of transactions described above in section 2.1.1. As a result, the IRS informed Amazon it owed 234 million dollar in additional taxes for the years 2005 and 2006.[26] Invoking section 482 of the Internal Revenue Code (IRC), the IRS undertook substantial transfer pricing adjustments reallocating income to Amazon US from AEHT.[27] Under this section, the Commissioner has a broad discretion and usually upholds its decision, unless the taxpayer shows it to be arbitrary, capricious

[24] *Amazon v IRS*, pp 22-26.
[25] Ibid, pp 26-27.
[26] Internal Revenue Service, 'Notice of Deficiency to Amazon.com, Inc. and Subsidiaries' (2012) Letter 531.
[27] *Amazon v IRS,* p 5.

or unreasonable, which is a question of fact.[28] The government took the position that Amazon improperly excluded costs from the cost sharing pools and that, therefore, the payments from AEHT were understated and not made at arm's length. The IRS concluded that the buy-in payment by AEHT had not been determined at arm's length and that such payment would have to amount to 3.468 billion dollar.[29] Moreover, it regarded the method used by the taxpayer to reduce cost center amounts as improper.[30] The allegations were contested by Amazon, which ultimately brought the case before the tax court in Seattle. On the contrary, the petitioner disputed the methodology used by the IRS in treating short-lived intangibles as if they had perpetual useful lives. Furthermore, the petitioner contended that each group of transferred assets must be valued separately under the comparable uncontrolled transaction (CUT) method. By rejecting the CUT method, the IRS urged substantially higher values for each group of assets (software, marketing intangibles and customer lists).[31]
Hence, on March 23, 2017, the US Tax Court decided the case *Amazon.com, Inc. v Commissioner of Internal Revenue*. The case required the court to decide on two main issues: the proper amount of AEHT's buy-in obligation with regard to the transferred assets and the volume of the costs properly treated as IDCs.[32]

To begin with, one important question the court answered concerned the existence of abuse of discretion on the side of the Commissioner. With respect to the cost sharing background, the court previously determined that the best-method rule 'seeks the most reliable measure of an arm's-length result'.[33] However, no strict priority of methods exists.[34] The regulations make clear that compensation for subsequently developed IP is not covered by the buy-in payment.[35] The position taken by the respondent was based on the expert report of Dr. Frisch, which rejected the use of the CUT method, but rather opted for the discounted cash flow (DCF) method. In effect, he treated the transfer of

[28] *Seagate Technology, Inc. and Consolidated Subsidiaries v Commissioner of Internal Revenue* [1994] 102 T.C., p 164; *Sundstrand Corporation and Subsidiaries v Commissioner of Internal Revenue* [1991] 96 T.C. 226, p 353.
[29] *Veritas Software Corporation & Subsidiaries, Symantec Corporation v Commissioner of Internal Revenue* [2009] 133 T.C., p 317.
[30] Internal Revenue Service, 'Explanation of Items' (2005 & 2006) Form 886A, p 9.
[31] *Amazon v IRS*, pp 7-8.
[32] Ibid, pp 6-7.
[33] *Veritas Software Corporation & Subsidiaries, Symantec Corporation v Commissioner of Internal Revenue* [2009] 133 T.C., p 327; Section 1.482-1(c)(1) Treasury Regulations.
[34] *Veritas Software Corporation & Subsidiaries, Symantec Corporation v Commissioner of Internal Revenue* [2009] 133 T.C., p 327.
[35] Section 1.482-7(g)(2) Treasury Regulations.

existing intangibles as economically equivalent to the sale of an entire business and as having a perpetual useful life. The court ruled that by assuming this, Dr. Frisch failed to restrict his valuation to the pre-existing intangible property, as required under section 1.482-7(g)(2) of the Treasury Regulations. Dr. Frisch improperly included subsequently developed intangibles in the buy-in payment. Hence, the court agreed with the petitioner's position, that the website technology that was transferred from Amazon US to AEHT had a useful life of seven years.[36] This conclusion primarily rested on the facts that AEHT assumed sole responsibility to maintain and develop the marketing intangibles in Europe and paid for the technological improvements to maintain their value.[37] Moreover, the Commissioner claimed that Amazon US could have availed itself of a realistic alternative by a continued ownership of all intangibles in the US. The court was not convinced by this argument. It emphasized the truism, that parties entering into a CSA always have the possibility not to do so in the first place. Unlike the respondent, the petitioner applied the CUT method to determine the buy-in payment by reference to the amount charged in a comparable uncontrolled transaction. The court agreed that this method is the most suitable one. Nevertheless, it did not wholly agree with the results of the petitioner, who failed to prove that the arm's length standard is met.[38] Ultimately, it further asserted that the structure as a whole did not lack economic substance: '[T]he mere fact of the parent's control over the subsidiaries […] [does] not establish the existence of an agency, since such control is typical of all shareholder-corporation relationships'.[39]

The second big issue concerned the cost sharing payments. The Treasury Regulations define these as costs incurred related to the intangible development area consisting of operating expenses plus charges for the use of certain tangible property. The costs must be allocated between the intangible development area and others such as business activities, on a reasonable basis.[40] In the CSA at hand, AEHT and Amazon US used a revenue-based formula to determine the benefit shares.[41] The parties' dispute focused on the technology and content cost center. On the one hand, the respondent determined

[36] *Amazon v IRS*, pp 76-77.
[37] Ibid, p 141.
[38] Ibid, pp 88-91; *G.D. Searle & Co. and Subsidiaries v Commissioner of Internal Revenue* [1987] 88 T.C. 252, p 367.
[39] *Commissioner v Bollinger* [1988] 485 U.S. 340, p 346.
[40] Section 1.482-7(d)(1) Treasury Regulations.
[41] *Amazon v IRS*, p 173.

that 100% of the costs accumulated in this category constitute IDCs. On the other hand, the petitioner contended that these costs are mixed costs and proved this at trial through documentary evidence and expert testimony.[42] The court upheld the opinion of the petitioner that the respondent abused its discretion in determining that 100% of the costs constitute IDCs. Thus, the respondent's position violated the principle that '[c]osts that do not contribute to the intangible development area are not taken into account'.[43]

As a result, the court held that the IRS's determination with respect to the buy-in payment was arbitrary, capricious and unreasonable. Moreover, the CUT method pursued by Amazon was the best method to determine the requisite buy-in payment as well as the cost-allocation method in order to allocate costs to IDCs.

2.2. Amazon bypassing UK tax presence

The Amazon affair in the United Kingdom (UK) concerned the Luxembourg company having a significant volume of sales to UK customers and a large warehouse in Milton Keynes. By pooling European sales in Luxembourg, Amazon paid less tax than it was supposed to under British law.[44] In order to ascertain whether AEU, the Luxembourg operation, amounts to a PE in the UK that can be taxed by Her Majesty's Revenue and Customs (HRMC) depends on a combination of laws, OECD guidelines and double taxation treaties. The HRMC focuses on whether there is an actual trading activity by the non-resident company, whether that trading takes place in the UK, whether that company has a fixed place of business in the UK and whether trade is carried out through this place or a dependent agent. If the answer to all these questions is yes, the HMRC will be able to levy corporation tax.[45] The Amazon UK resident company claimed not to sell to British shoppers but only to provide fulfillment and corporate support services to Luxembourg, namely warehouse operations.[46] This practice was based on international tax rules, which allow companies such as Amazon to conduct

[42] Ibid, pp 174-177.
[43] Section 1.482-7(d)(1) Treasury Regulations.
[44] Simon Bowers, 'Amazon's UK business paid just £11.9m in tax last year' (The Guardian 2015) <https://www.theguardian.com/technology/2015/jun/24/amazons-uk-business-paid-119m-tax-last-year> accessed 20 June 2018.
[45] Her Majesty's Revenue & Customs, 'HMRC issue briefing: taxing the profits of companies that are not resident in the UK' (UK Government) <https://www.gov.uk/government/publications/issue-briefing-taxing-the-profits-of-companies-that-are-not-resident-in-the-uk/hmrc-issue-briefing-taxing-the-profits-of-companies-that-are-not-resident-in-the-uk> accessed 20 June 2018.
[46] Ian Griffiths, 'Tax: how Amazon passed the Slough test and prospered' (The Guardian 2013) <https://www.theguardian.com/business/2013/may/15/corporate-governance-amazon> accessed 20 June 2018.

preparatory and auxiliary activities in a country without creating a taxable presence.[47] Since the standard OECD guidelines specifically recognized that a warehouse might not be sufficient to constitute a PE, Amazon's profits were not taxable in the UK.

Over the past decades, companies increasingly designated their British subsidiary as a supplier of support services to an affiliate in a low tax jurisdiction. Surprisingly, the HMRC never sought to define the limits of what a digital company can do in the UK before it is deemed to have a taxable presence.[48] Further case law is necessary in this respect. Action 7 of the BEPS project focuses on such situations in order to prevent and avoid them from happening in the future. Thus, the outcome of this contention could be a lot more different once the BEPS Action Plan is fully implemented by countries, such as the UK. As will be later explored in section 6.3., the UK adopted an alternative measure to counter the artificial erosion of the British tax base.

2.3. EU Commission investigations against Luxembourg and Amazon

Additionally, Amazon was likewise at the heart of state aid investigations undertaken by the European Commission. The state of Luxembourg was suspected of having granted unfair tax advantages to the company.[49] According to an American newspaper, Jean-Claude Juncker, former Prime Minister of Luxembourg and current President of the European Commission, participated in secret meetings with Amazon's tax officials already back in 2003.[50]

At the end of the year 2017, the European Commission concluded that Luxembourg granted undue and illegal tax benefits to Amazon of a value of 250 million euro. The commissioner in charge of the competition policy, Margrethe Vestager, clarified that almost three quarters of Amazon's profits remained untaxed.[51] Hence, the company was allowed to pay substantially less taxes than other local companies subject to the same national tax rules. Thereupon, the tax ruling issued by Luxembourg in 2003 and prolonged in 2011, lowering the tax paid by Amazon, could not be validly justified.

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[47] Article 5(4) OECD MTC.

[48] Tom Bergin, 'After Google, Amazon to be grilled on UK tax presence' (Reuters 2013) <https://uk.reuters.com/article/uk-britain-tax-amazon/after-google-amazon-to-be-grilled-on-uk-tax-presence-idUKBRE94G06320130517> accessed 20 June 2018.

[49] Simon Marks, 'How Amazon saved billions in taxes' (Newsweek 2016) <http://www.newsweek.com/behind-amazons-tax-strategy-494325> accessed 20 June 2018.

[50] Ibid; *Amazon.com, Inc. & Subsidiaries v Commissioner of Internal Revenue*, Amended Simultaneous Opening Brief (2016) Docket No. 31197-12, p 88.

[51] European Commission, 'State Aid: Commission finds Luxembourg gave illegal tax benefits to Amazon worth around €250 million' (Press release 2017), p 1.

This tax ruling enabled Amazon to shift its profits from Amazon EU, the group company subject to Luxembourg tax, to a company not subject to tax, AEHT.[52] Under Luxembourg's tax laws, the operating company (Amazon EU) is subject to corporate taxation, whilst the holding company (AEHT) is not because of its legal form, a limited partnership.[53] Hence, profits are only taxed at the level of the partners, which are all located in the US. Moreover, the level of royalty payments was inflated and did not reflect the economic reality.[54] The Commission emphasized that payments between two companies in the same group should be in line with arrangements that take place under commercial conditions between independent businesses, at arm's length. The Commission investigated Amazon's method to calculate the taxable base of the operating company. It found that the payments made from Amazon EU to the holding company were significantly higher than what Amazon EU needed to pay under the cost sharing agreement. Accordingly, the operating company was the only entity actively taking decisions and carrying out business. On the other side, the holding company was merely an empty shell passing on intellectual property rights to the operating company.[55]

As matter of principle, EU state aid rules require that incompatible state aid be recovered to remove the distortion of competition.[56] In the Commission's decision, it estimated that the competitive advantage given to Amazon amounted to 250 million euro. The state of Luxembourg will have to precisely determine the amount of unpaid tax on the basis of this decision.[57] In order to prevent the use of such complex structures for the purpose of circumventing taxes, the OECD elaborated a wide-ranging Action Plan.

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[52] Ibid, p 1.
[53] Philip Warner, *Luxembourg in International Tax Planning* (IBFD 2004), pp 10-11.
[54] European Commission, 'State Aid: Commission finds Luxembourg gave illegal tax benefits to Amazon worth around €250 million' (Press release 2017), p 1.
[55] Ibid, p 2.
[56] Article 108 TFEU; Bucura Mihaescu-Evans, 'Recovery of Unlawful Aid and the Role of National Courts', in Herwig Hofmann and Claire Micheau, *State Aid Law of the European Union* (OUP 2016), p 382.
[57] European Commission, 'State Aid: Commission finds Luxembourg gave illegal tax benefits to Amazon worth around €250 million' (Press release 2017), p 3.

3. BEPS Action 1 – Digital economy

International tax issues have never been faced by as much political debate as they do today. Public pressure in relation to business tax issues is rare, but the disclosure concerning Amazon, Apple and other MNEs has pushed politicians to respond. Political attention has not only reached the ministers of finance but even the heads of state.[58] In particular, the BRICS countries have articulated opposition to the existing treaty system, which they consider detrimental to their economies.[59] The modification and restructuring of international tax rules is a very challenging task, especially when it comes to reaching consensus among countries. A reason for this are the different roles countries play in the world economy, advocating competition for international tax policies. For example, the United States economy thrives on innovation. The biggest driver for growth and profits is the development of intellectual property by resident MNEs. In contrast, France supports employment by charging higher prices for products produced and sold within the country. China's growth has been largely driven by its ability to manufacture at a low cost through the large population working for low wages. Whereas, Brazil relies predominantly on the export value of its commodities, like many other developing countries. This illustrates the different positions that can be taken on how international tax rules should be designed to allocate profits amongst countries.[60]

Resulting from this political pressure, the OECD and the Group of Twenty (G20)[61] countries adopted a 15-point Action Plan to address base erosion and profit shifting in September 2013. The key aspects to be undertaken have been identified as constituting the coherence in domestic rules affecting cross-border activities, the reinforcement of substance requirements in existing international standards and an improved

[58] George Osborne, Pierre Moscovici and Wolfgang Schäuble, 'We are determined that multinationals will not avoid tax' (Financial Times 2013); See G20, 'Leaders Declaration' (Saint Petersburg 2013) <http://www.g20.utoronto.ca/2013/Saint_Petersburg_Declaration_ENG.pdf> accessed 20 June 2018; Mindy Herzfeld, 'The Case Against BEPS: Lessons for Tax Coordination' (2017) University of Florida Levin College of Law Research Paper No. 18-3, p 14.

[59] Note: BRICS is the acronym for the major emerging economies of Brazil, Russia, India, China and South Africa; Mindy Herzfeld, 'Who Will Control the Future of International Tax Policy?' (2015) 78 Tax Notes International, p 419.

[60] Mindy Herzfeld, 'The Case Against BEPS: Lessons for Tax Coordination' (2017) University of Florida Levin College of Law Research Paper No. 18-3, p 19; Stefan Bendlinger, 'Hilfsbetriebsstätten in BEPS-Action 7' (2016) 4 SWI, p 188.

[61] Note: the G20 is a forum for international co-operation that brings together representatives of 20 economies, for more information consult http://www.oecd.org/g20/about.htm.

transparency and certainty. The BEPS package represents the first substantial remodeling of international tax rules in almost a century.[62]

Action 1 deals with the tax challenges of the digital economy. The driving force behind the introduction of this plan has been the growing concern about tax planning by multinational enterprises that are based on newly established business models. Many of these big players make use of gaps, which exist due to the interaction of different tax systems, in order to artificially reduce taxable income or to shift profits to low-tax jurisdictions in which no or little economic performance is carried out.[63]

The digital economy resulted from a transformation, improving business processes and bolstering innovation through information and communication technology. The new business models emerging therefrom become especially relevant from a tax perspective. Essential business features include mobility, reliance on data, network effects, volatility and the tendency towards monopoly and oligopoly. Business models incorporating such elements encompass e-commerce, app stores, online advertising, cloud computing, networked platforms, online payment services and many more.[64]

3.1. Digital business and economy models

Digital economy is defined as 'the global network of economic and social activities that are enabled by platforms such as the Internet, mobile and sensor networks'.[65] It is characterized by an unparalleled reliance on intangibles, the use of data, the adoption of multi-sided business models and the difficulty of determining the jurisdiction in which value is created. New ways of doing business may result in the relocation of core business functions and, consequently, result in a different distribution of taxing rights. Hence, companies with a significant digital presence in the economy of another country than their home country are able to escape taxation due to the lack of nexus there.[66] The G20 emphasized already at their meeting in 2013 that 'profits should be taxed where economic activities deriving the profits are performed and where value is created

[62] OECD, 'Addressing the Tax Challenges of the Digital Economy – Action 1: 2015 Final Report' (2015) OECD/G20 Base Erosion and Profit Shifting Project (BEPS Action 1), p 3.
[63] Ibid, p 11.
[64] Ibid, p 11.
[65] OECD, 'OECD Digital Economy Outlook 2015' (OECD Publishing 2015), p 11 <https://read.oecd-ilibrary.org/science-and-technology/oecd-digital-economy-outlook-2015_9789264232440-en#page13> accessed 20 June 2018.
[66] BEPS Action 1, p 16.

[…]'.[67] The digital economy deals with, amongst others, those business models and key features as described in the sections below.

3.1.1. New business models

The rapid technological progress has brought prices of ICT products down, which become successful and, ultimately, reach a greater market leading to the growth of the digital economy. There is a constant pressure for innovation as it becomes easy for products to be copied by competitors. This is stimulated further by the process of standardization, making components interoperable, and thus making it more burdensome for individual producers to distinguish their products from others. Accordingly, producers are forced to compete solely on the price of the commodity or move to another market.[68] Nowadays, all sectors of the economy have adopted ICT to enhance productivity, enlarge market reach and reduce operational costs. Such widespread adoption, together with the rapid decline in price and increase in performance has contributed to the development of new activities. Businesses across all sectors are able to design and build their operating models around technological capabilities, improving flexibility, efficiency and their reach into global markets.[69] The number of new business models is manifold. Electronic commerce is one of them and defined as 'the sale or purchase of goods or services, conducted over computer networks by methods specifically designed for the purpose of receiving or placing of orders. […]'.[70] Relating to e-commerce are online payment services providing a secure way to enable payments online without requiring the parties to the transaction to share financial information with each other.[71] Moreover, the growth of Internet access through smartphones and tablets has caused an increase in the frequency of use of online services and the development of application stores. It can be regarded as a type of digital distribution platform for software.[72] In addition to these three main digital business models further models, such as online advertising, cloud computing, high frequency trading and participative network platforms, conquer the digital market.[73]

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[67] G20, 'Leaders Declaration' (Saint Petersburg 2013), p 12 <http://www.g20.utoronto.ca/2013/Saint_Petersburg_Declaration_ENG.pdf> accessed 20 June 2018.
[68] BEPS Action 1, p 36.
[69] Ibid, pp 52-53.
[70] OECD, 'OECD Guide to Measuring the Information Society' (OECD Publishing 2011), p 72.
[71] BEPS Action 1, p 57.
[72] Ibid, p 58.
[73] Ibid, pp 58-62.

Hence, digital businesses are mainly based on intangible assets, rather than on fixed assets. Such key value drivers (mostly royalties paid for patents, trademarks or brand names) are often owned and licensed in countries with attractive taxation rates for profits derived from these assets. In the EU, certain countries, such as Luxembourg, offer intellectual property box tax regimes, stimulating tax-motivated profit shifting.[74] As was previously discussed, Amazon structured their business accordingly by assigning their key IP assets to Luxembourg subsidiaries. Moreover, digital businesses are based on goods and services marketed through websites, rather than traditional commercial workforce, avoiding a substantial physical presence in the end-user country.[75]

3.1.2. Key features of the digital economy

There are a number of aspects, which are increasingly prominent in the digital economy and gaining relevance from a tax perspective. First of all, mobility with respect to intangibles, users and business functions becomes crucial. Development and exploitation of intangibles is a core contributor to the creation of value of many businesses in the digital economy. Under existing tax rules, the rights to those intangibles can often be assigned and transferred among associated enterprises, with the effect of separating ownership of the assets from the activities that led to their development. Furthermore, users are able to carry on commercial activities remotely, while crossing borders. The location where the ultimate sale took place may be disguised and the interaction and user may remain anonymous on the Internet. This is not only true for individuals. This place may not have to correspond to either the location where operations are carried out or the location where the customer is located.[76] The mobility of intangible assets has resulted in low costs concerning storing and producing, facilitating the establishment of a company in a new market.[77]

Secondly, the collection of data about customers, users, suppliers and operations is common in the digital economy, but not unique to it. It has previously been accepted to use information about transactions and interactions with customers to improve business.

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[74] Jean-Louis Medus, 'Digital Business and Permanent Establishment (some critical comments of BEPS' proposals to regulate digital business)' (2016), p 5 <https://www.archers.fr/wp-content/uploads/2016/12/Vdef-BEPS-and-PE-Journal-of-international-Taxation.pdf> accessed 20 June 2018.

[75] Ibid, p 5.

[76] BEPS Action 1, pp 64-65.

[77] European Commission, 'Commission Expert Group on Taxation of the Digital Economy' (Report 2014), p 11.

However, the developing participatory culture makes it easier for companies to leverage and monetize such activities.[78]

Thirdly, decisions of users may have a direct impact on the benefit received by other users, the so-called network effects. An example is a media-sharing site in which case the more users there are, the higher the value created is. In such websites, content is created and shared by users. The review contributed by users enhances the ability of future users to make informed choices.[79] Many of these businesses are multi-sided, being based on a market in which multiple distinct groups of persons interact through an intermediary or platform and the decision of each group affects the outcome for the other groups through a positive or negative externality (such as price decrease or increase). For example, a payment card system will become more valuable if more consumers use the card and more merchants accept it.[80] In some markets, network effects and low incremental costs may enable an enterprise to quickly achieve a dominant position, especially where it is the first actor to gain importance in an immature market. This power is enhanced by intellectual property rights and the exclusive ability to exploit an innovation.[81]

Last but not least, volatility is an important feature. Neither an Internet user, nor a service provider is required to pay marginal prices for using the network. Combined with the other factors, this reduces barriers to entry for new digital businesses. In principle, volatility can thus limit monopolistic power on the market as innovation and new ideas are fostered. However, in practice, thorough research, development and the investment into resources usually enable MNEs to maintain their monopolistic position.[82] These features facilitate opportunities for MNEs to avoid paying taxes in countries where they operate, as presented in the next sections.

3.2. Tax avoidance practices

International tax planning aims at taking advantage of the tax rate, as well as tax base differentials across various states. This phenomenon is also known as tax arbitrage. It often results in a race to the bottom.[83] BEPS concerns are raised by situations in which

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[78] BEPS Action 1, pp 68-69.
[79] Ibid, p 71.
[80] Ibid, pp 71-72.
[81] Ibid, p 73.
[82] Ibid, p 73.
[83] Jean-Louis Medus, 'Digital Business and Permanent Establishment (some critical comments of BEPS' proposals to regulate digital business)' (2016), pp 2-3 <https://www.archers.fr/wp-

taxable income can be artificially segregated from the activities that generate it. These situations undermine the integrity of any tax system and make it more difficult to reach the revenue goals. They may also have the effect of distorting competition, as enterprises operating only in domestic markets or refraining from BEPS actions may face a competitive disadvantage over MNEs, which have the ability and power to avoid or reduce tax by shifting profits across borders.[84] In sum, four main BEPS strategies can be discerned in the context of direct taxation.

3.2.1. Avoidance and minimization of taxation

The first element concerns minimization or elimination of taxation in the market country by avoiding a taxable presence. In the modern digital economy, non-resident countries may interact with customers remotely through a website or other digital means without maintaining a physical presence in that country. Most jurisdictions require a certain degree of physical presence before business profits will be subject to taxation.[85] In addition, Articles 5 and 7 OECD MTC reiterate that corporations' business profits are subject to tax in the country, where it is not a resident, only in case it has a permanent establishment there.[86] Corporations in many sectors of the industry have customers in a country without PE, communicating via phone, mail and independent agents. The result of such strategy being that revenue is left untaxed.[87] Moreover, taxation can equally be avoided by dividing operations among group entities in order to qualify for the exceptions to a PE under Article 5 OECD MTC by ensuring that each location where activities are carried out falls below the threshold and is regarded as merely preparatory and auxiliary.[88] In particular, intangibles and risks carried out at the local level may be allocated via contractual arrangements to other group members operating in a low-tax jurisdiction, thus minimizing the overall tax burden for the MNE, as was the case for Amazon. There is an incentive for the affiliate in the low-tax environment to undervalue the transferred assets, while claiming that it is entitled to have large portions of the group's income allocated to it, justified by legal ownership, financing and the assumption of the risk. Hence, profits are shifted to a low-tax

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content/uploads/2016/12/Vdef-BEPS-and-PE-Journal-of-international-Taxation.pdf> accessed 20 June 2018.

[84] BEPS Action 1, p 78.

[85] Ibid, pp 78-79.

[86] Articles 5 and 7 OECD MTC.

[87] BEPS Action 1, p 79.

[88] Article 5(4) OECD MTC.

jurisdiction and, thus, reduced.[89] This is especially true when it comes to the availability of special IP boxes. For example, such tax rate in Luxembourg amounts to 5.6%, representing only one third of the normal corporate tax.[90]

Once a taxable presence in the market country has been established, it may occur that gross profits are shifted via trading structures or that the net profit is reduced by maximizing deductions. Maximization of deductions may occur in the form of interest, royalties or service fees.[91]

3.2.2. Avoidance and reduction of the withholding tax

The second strategy often pursued by MNEs is to pay a low or no withholding tax. A corporation may be subject to a withholding tax in a country, in which it is not resident if it receives certain payments in those countries, such as interest or royalties. Nevertheless, companies active in the digital economy may escape such withholding tax or only pay a reduced amount. By means of establishing shell companies in jurisdictions with favorable treaty networks, treaty shopping and treaty abuse arises.[92]

3.2.3. Avoidance and reduction of taxation in the intermediate country

Another BEPS strategy is the low or no taxation at the level of the recipient, often built via intra-group arrangements. This can be accomplished by the use of hybrid mismatch arrangements, the choice of a preferential domestic tax regime or by excessive deductible payments made to related entities in low-tax jurisdictions. With regard to the digital economy, and as was the case for Amazon, the rights in intangibles and related returns can be transferred among associated enterprises. This often happens at a price below arm's length. The transfer occurs in a jurisdiction where income earned from these intangibles is subject to a low tax or even none at all. Such strategies present substantial risks of base erosion as tax planning opportunities emerge. Alternatively, operating companies located in an intermediate jurisdiction may use intangibles held by another affiliate in a low-tax jurisdiction. The royalties for the use of these assets may

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[89] BEPS Action 1, p 80.

[90] Jean-Louis Medus, 'Digital Business and Permanent Establishment (some critical comments of BEPS' proposals to regulate digital business)' (2016), p 8 <https://www.archers.fr/wp-content/uploads/2016/12/Vdef-BEPS-and-PE-Journal-of-international-Taxation.pdf> accessed 20 June 2018; Note: the Luxembourg tax rate for companies that earn more than 30.000 euro is 18% (plus surcharge of 7%).

[91] BEPS Action 1, pp 80-81.

[92] Ibid, p 81.

be used to eliminate taxable profits in the intermediate country.[93] Many more examples of such structures exist, which will not be further analyzed in this paper.

3.2.4. Avoidance and reduction of taxation of the parent

A further BEPS strategy is the avoidance of taxation of low-tax profits at the level of the ultimate parent. This can be done by employing the same techniques as for reducing taxation in the market country. Accordingly, contractual arrangements allocating risks and legal ownership of assets to group entities in low-tax jurisdictions can be concluded. Furthermore, if the residence country of the parent has an exemption or deferral system for foreign-source income and does not possess controlled foreign company (CFC) legislation or an adequate regime to cover various categories of passive income, companies may easily avoid tax there.[94]

3.3. Tax challenges raised by the digital economy

Advances in ICT have dramatically expanded the scale at which non-resident companies are able to sell into jurisdictions without physical presence there. Such advancement, coupled with progress in development of business practices and more liberalized trade policies, allowed businesses to centrally manage functions, which previously required local presence. Hence, the traditional model of doing business is rendered obsolete, in which case many challenges for international taxation are raised.[95] In the area of direct taxation, the main challenges concern nexus, data and characterization.

3.3.1. Lack of physical presence

The increase and advances in technology and the reduced need of a physical presence in the digital economy, raise doubts as to whether the current rules to determine nexus continue to be appropriate. Despite the growth and development of technologies, the fundamental nature of the core activities carried out by businesses to generate profits has not changed. Businesses still need to source and acquire inputs, create and add value, and sell to customers in order to generate income and profits. The digital economy has changed the way though in which these activities are carried out. For example, it is much easier and common to exercise activities and functions remotely, to increase the speed at which information is processed, analyzed and utilized, and to

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[93] Ibid, pp 81-82.
[94] Ibid, p 82.
[95] Ibid, p 98.

expand the number of potential customers. The enlarged flexibility gives companies the competence to choose where the substantial activities take place and to move to new locations. The main issue relates to the concept of PEs. It does not only refer to the physical presence in a country, but also to situations where the non-resident MNE carries on business in the country concerned via a dependent agent. Moreover, activities, which have previously been considered to be merely preparatory or auxiliary, may constitute an increasingly significant part of the business activities.[96]

3.3.2. Data and the attribution of value

Many companies in the digital era gather and use information across borders to an unprecedented degree. Such data do not correspond anymore to mere auxiliary activities but often constitute the core business. The question arises how value created from the generation of data shall be attributed and how the data involved shall be characterized. The leveraging of data can create value for businesses in various ways. It is not clear whether the remote collection of data should give rise to nexus even in the absence of a physical presence. Further pressure is placed on this concern, since tax results can be affected if such value is attributable to a PE or if held by a local subsidiary and sold to a foreign company.[97]

3.3.3. Characterization of income derived from new business models

The expansion of new digital products and services creates uncertainties in relation to the proper characterization of payments in particular. It is not yet clear whether such payments, often made in relation to cloud computing, should be treated as royalties, fees for technical services or business profits. Moreover, additional administrative challenges arise in this regard, which will not be further discussed here.[98]

3.4. Solutions proposed by the OECD to tackle BEPS in the digital economy

The aim of the BEPS Action Plan is to address the above-described issues at the level of the market jurisdiction, but also at the level of the parent company jurisdiction. The ultimate goal is to put an end to stateless income, which remains untaxed anywhere. Especially Action 7, preventing the artificial avoidance of the PE status, was identified to be of particular relevance in this regard. Certain activities that were previously considered preparatory or auxiliary under Article 5(4) OECD MTC may be increasingly

[96] Ibid, pp 100-102.
[97] Ibid, pp 102-104.
[98] Ibid, pp 104-105.

significant components of digital businesses. As a result, Action 7 considers how and to what extent the definition of a PE needs to be modified.[99]

Certain measures under the BEPS Action Plan will be directly applicable, while others require domestic law changes. Many of the proposals will result in adjustments to the OECD MTC. In order to update the global network of tax treaties, many countries have engaged in negotiations over a multilateral instrument to implement the BEPS measures and to adapt bilateral tax treaties in an efficient and synchronized manner.[100]

3.4.1. Amending the existing PE definition under Article 5 OECD MTC (Action 7)

The definition of a PE under the treaty may limit the application of domestic law rules applicable to the taxation of business profits of non-resident companies derived from sources in the market country. In order to prevent an artificial avoidance of the PE threshold, the work done by the Task Force on the Digital Economy (TFDE) involved modifying the definition of a PE to address circumstances where artificial arrangements relating to sales of a company in a multinational group and resulting in the conclusion of contracts be treated as if they had been made by that company. Additionally, enterprises cannot benefit from the list of exceptions under Article 5(4) OECD MTC, where essential business activities are carried on at a given location in a country. Consequently, this paragraph was modified to restrict each exception to preparatory or auxiliary activities. Likewise, a new anti-fragmentation rule was introduced to ensure that it is not possible to benefit from the exceptions by fragmenting business activities among closely related enterprises. As a result, where certain activities, which previously fell under one of the exceptions, have become important components of the business, they will no longer be entitled to the exception from the PE status. This is especially true for large warehouses of MNEs, such as the UK warehouse of Amazon.[101]

3.4.2. Aligning transfer pricing outcomes with value creation (Actions 8-10)

It is important to estimate that the allocation of profits and transfer pricing between various assets is a major tax issue. In particular, transfer pricing is used to reduce and minimize income attributable to functions and risks in consumer markets and to

[99] Ibid, pp 86-87.
[100] Ibid, p 94.
[101] Ibid, p 88.

maximize income allocation to entities owning IP assets located in countries with favorable tax regimes.[102]

The overall objective of the transfer pricing actions is to bring the allocation of income within a multinational group of companies more in line with the location of the economic activity, giving rise to the income.[103] Many BEPS structures involve the transfer of intangibles to tax advantaged locations. Such transfers can occur at non-arm's length prices and might be connected to license agreements, cost contribution arrangements and separation of deductions. Hence, Actions 8-10 provide a clear definition of intangibles for transfer pricing purposes and provide that any transfer between related enterprises must be compensated, as would be the case where the parties are unrelated. It ensures that companies within a MNE group, which contribute value to intangibles, are appropriately rewarded for doing so. Moreover, the BEPS project confirmed that the transaction profit split method is the most useful when applied to align profits with value creation in certain circumstances. [104]

4. BEPS Action 7 – Permanent establishment

Most international tax treaties are based on the model treaty of the OECD and generally provide that business profits of a foreign company are taxable in a state only to the extent that the company has a permanent establishment in that state to which the profits are attributable.[105] Two main principles govern the OCED MTC. On the one hand, the taxing right of the source country is acknowledged, which can be limited from time to time. In the case of profits generated by a permanent establishment, it has the unlimited taxing right though.[106] On the other hand, the conditional taxing right of the residence country is recognized. According to Article 7(1) OECD MTC, business profits are taxed in the state of residence of the enterprise, unless the profits are attributable to a PE in a foreign source country. When the source country exercises this right, the residence

[102] Jean-Louis Medus, 'Digital Business and Permanent Establishment (some critical comments of BEPS' proposals to regulate digital business)' (2016), p 8 <https://www.archers.fr/wp-content/uploads/2016/12/Vdef-BEPS-and-PE-Journal-of-international-Taxation.pdf> accessed 20 June 2018.
[103] OECD, 'Aligning Transfer Pricing Outcomes with Value Creation – Actions 8-10: 2015 Final Reports' (2015) OECD/G20 Base Erosion and Profit Shifting Project.
[104] BEPS Action 1, pp 90-92.
[105] Article 5 OECD MTC.
[106] Article 7(1) OECD MTC.

country grants relief for the taxes paid in the source country through the credit or exemption method in order to avoid double taxation.[107]

The BEPS Action Plan called for a review of the PE definition in order to prevent the use of common tax avoidance strategies that are used to circumvent the threshold of a PE, as described above in section 3.2. Accordingly, Action 7 on Preventing the Artificial Avoidance of Permanent Establishment Status was completed to deal with this issue.

4.1. Concept of PEs

The concept of PE is one of the most crucial ones in the field of international taxation. It determines whether the source state can legitimately claim taxing rights in respect to income generated on its territory.[108] A PE can be defined as a fixed place of business, through which business is carried on.[109] This includes a place of management, a branch, an office or a factory.[110] A PE has no veil of incorporation and cannot be considered as a legally distinct entity subject to pass-through taxation. The profits and losses that are attributable to the PE are deemed to be taxable income of the domestic head-office.[111] Nevertheless, from a tax point of view, a PE is treated as functionally independent company with a fiscal personality and subject to tax in the source country where the PE is located.[112] The company's total profit is attributed to the domestic and foreign part of the enterprise, in accordance with the arm's length principle. This principle foresees that transactions made between associated enterprises should be priced the same as transactions between unrelated parties.[113]

The concept of PE does not only refer to the physical presence in a country, but also to situations where non-resident companies carry on business in a country via dependent agents. In the digital era, it is possible and common to be heavily involved in the economic life of a country without having a taxable presence there. The effect brought

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[107] Articles 23A and 23B OECD MTC.
[108] Atanas Atanasov, 'Permanent establishment 2.0 – is it time for an update?' (2017), p 14.
[109] Article 5(1) OECD MTC.
[110] Article 5(2) OECD MTC.
[111] Jean-Louis Medus, 'Digital Business and Permanent Establishment (some critical comments of BEPS' proposals to regulate digital business)' (2016), p 7 <https://www.archers.fr/wp-content/uploads/2016/12/Vdef-BEPS-and-PE-Journal-of-international-Taxation.pdf> accessed 20 June 2018.
[112] Articles 7(1) and (2) OECD MTC.
[113] Article 7(2) OECD MTC.

about is the non-taxation of such transactions as a whole. Profits are shifted out of the country where the sales take place, while continuing to perform further actions in that country. Therefore, the existing concept of PE, which stipulates that an enterprise needs to have a physical presence, has made it practically impossible for the source state to levy taxes on sales originated through websites. The virtual environment is new to many jurisdictions. The OECD only recognizes that computer servers could be considered a PE, but not websites.[114] Relying on the physical presence of the server, digital companies is given large room for tax planning to locate the server in a jurisdiction with low or no tax rates. Next to this, often, MNEs artificially fragment their business operations among group entities to qualify for the exceptions to the PE status. These phenomena lead to the conclusion that the definition of PE has to be updated to prevent the artificial avoidance of the PE status, including through the use of commissionaire arrangements and the specific activity exemptions.[115]

4.2. Artificial avoidance of the PE status and the solution pursued

The sections below will discuss certain strategies in order to circumvent the PE status. The main strategies concern the specific activity exemptions, the fragmentation of business activities and commissionaire arrangements. Other strategies, such as the splitting up of contracts or the sale of insurance will not be further evaluated in this paper.

4.2.1. Specific activity exemptions

In particular, the exemptions provided for under Article 5(4) OECD MTC, under which a PE is deemed not to exist, are regularly exploited in respect of the digital economy. It may happen that a PE contributes to the productivity of a business, but that the services performed are so remote from the actual realization of profits that no profits can be allocated to the place of business in question. It is decisive whether or not the activity forms an essential and significant part of the enterprise as a whole.[116] The activities covered under this provision were generally considered to be of preparatory and

[114] Monica Gianni, ’The OECD’s Flawed and Dated Approach to Computer Servers Creating Permanent Establishments’ (2014) 17 Vanderbilt Journal of Entertainment and Technology Law, p 31.
[115] OECD, ’Preventing the Artificial Avoidance of Permanent Establishment Status – Action 7: 2015 Final Report’ (2015) OECD/G20 Base Erosion and Profit Shifting Project (BEPS Action 7), pp 13-14.
[116] Tan Ching Kee and Henry Syrett, ‘Impact of OECD BEPS Action 7 proposals on modification of Articles 5(4), 5(5) and 5(6) of OECD Model Convention – An evaluation of Action 7 on the future of intra-group transactions and business models of MNEs in their cross-border investments’ (2017) 5 SMU School of Accountancy Research Paper Series 2, p 11; OECD, ’Commentary on Article 5 Concerning the Definition of Permanent Establishment’ (2015) (Commentary on Article 5), para 24.

auxiliary nature. However, nowadays such activities may correspond to core business activities. Paragraph 4 lists a number of business activities which limit the general definition under paragraph 1 and which, when carried on through a fixed place of business, are not sufficient to constitute a PE.[117] As a general rule, an activity of preparatory nature is carried on in contemplation of executing the essential and significant part of the activity as a whole. Thus, a preparatory activity precedes another activity, usually within a short period. Whereas, the function of an auxiliary activity is to support the essential part of the activity as whole, without formally being part of it.[118]

Subparagraph a of Article 5(4) OECD MTC relates to the maintenance and usage of warehouses.[119] No further changes occur within this paragraph. The same is true for subparagraphs b to d, which deal with the stock of goods, premises for purchasing goods and merchandise, and the collection of information.[120] Subparagraph e amounts to a rather broad and general restriction of the scope of a PE by providing that any activity that is not otherwise listed in paragraph 4 may fall out of the realm of a PE, as long as that activity has a preparatory or auxiliary character.[121] The next subparagraph applies to any combination of the activities mentioned in the other subparagraphs. In both subparagraphs e and f, the explicit referral to preparatory and auxiliary activities has been erased in order to add a completely new last sentence subjecting all of the exceptions to this requirement.[122]

As a result, Article 5(4) OECD MTC is changed accordingly, so as to restrict each exception to an activity that is of real preparatory and auxiliary character, as specified in the final part of the provision.[123] The OECD further clarifies that the preparatory and auxiliary character of any exertion must be viewed in the light of other actions that comprise complementary functions, which are nevertheless part of the cohesive business and which the company or any related company carries out in the same state. The fact whether the activity of the fixed place of business presents a substantial and

[117] BEPS Action 7, pp 28-29.
[118] Ibid, p 30; Commentary on Article 5, para 21.2.
[119] Article 5(4) OECD MTC; BEPS Action 7, p 31; Commentary on Article 5, para 22.
[120] Article 5(4) OECD MTC; BEPS Action 7, pp 32-34; Commentary on Article 5, paras 22.3-22.6.
[121] BEPS Action 7, p 29; Commentary on Article 5, para 21.
[122] BEPS Action 7, pp 28-29; Commentary on Article 5, para 4.
[123] BEPS Action 7, pp 9-10.

significant part of the business activity as a whole will be used as decisive criterion and will have to be examined on a case-by-case basis.[124]

This criterion of comparison has resulted in numerous cases before national courts. A prominent example is the German Pipeline Case, where a Dutch enterprise transported oil in their pipelines to its customers located in Germany. The German tax authorities claimed that the enterprise was liable to tax there since the pipeline partly ran through German grounds, constituting a PE. The enterprise opposed this assumption as neither employees nor installations were present there. Ultimately, the federal tax court decided in favor of the tax authorities and justified its conclusion by the fact that the oil transportation functioned as the core activity of the company.[125]

4.2.2. Fragmentation of business activities

Relating thereto, the concern on the fragmentation of activities arises under the same provision, namely under subparagraph f. It is important to regulate that MNEs, which are able to easily alter their structures to obtain tax advantages, cannot avoid the PE status by fragmenting their business into several small operations, which can in turn be regarded as merely preparatory or auxiliary under Article 5(4) OECD MTC.[126] The OECD has decided to focus on addressing two major issues. Firstly, the activities carried out by the same enterprise at different places will be taken into account. Secondly, the activities carried out by closely related enterprises at different places or even the same place will have to be considered.[127]

In response thereto, a new paragraph has been added to Article 5 OECD MTC introducing the anti-fragmentation rule. It specifies that Article 5(4) OECD MTC does not apply to a fixed place of business if the company or a closely related company carries on business activities at the same place or at a different place in the same country and either the place constitutes a PE, or the activity as a whole is not of a preparatory or auxiliary character. Furthermore, the business activities carried on by the two companies complement each other and form part of the same operation.[128]

By virtue of the inclusion of the anti-fragmentation rule, some states consider that there is no need to modify Article 5(4) OECD MTC and to subject all exceptions to the

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[124] BEPS Action 7, p 30; Commentary on Article 5, para 21.
[125] *German Pipeline Case* [1996] II R 12/92.
[126] BEPS Action 7, p 10; Commentary on Article 5, para 27.1.
[127] BEPS Action 7, p 39.
[128] BEPS Action 7, p 39; Commentary on Article 5, para 27.

condition of being preparatory and auxiliary. Consequently, the commentary on Article 5 OECD MTC indicates that states may adopt a different version of Article 5(4) OECD MTC, as long as they include the anti-fragmentation rule.[129]

4.2.3. Commissionaire arrangements

Artificial avoidance of the PE status may also occur through commissionaire arrangements and similar strategies. A commissionaire arrangement refers to an arrangement where a person sells products in a state in its own name but on behalf of a foreign company, the owner of these products. Thus, the company is able to sell its products in a state without being permanently established and taxed there. The person concluding the sales will not be taxed either on the profits since it is not the owner of the product, and may therefore only be taxed on the remuneration received (the commission). As a result, the foreign company is able to avoid the application of Article 5(5) OECD MTC, to the extent that the contracts concluded by the commissionaire are not binding on it.[130] Comparable situations falling within the range of Article 5(5) OECD MTC involve circumstances where contracts which are substantially negotiated in a state are not formally concluded there, but rather finalized abroad or where the person exercising the authority to conclude contracts constitutes an independent agent benefitting from the exception under Article 5(6) OECD MTC.[131] As a matter of policy, the activities exercised by the intermediary, resulting in the regular conclusion of contracts with a foreign company, on behalf of this company should be considered to have a sufficient nexus to be taxed there, unless the intermediary performs its functions in the course of an independent business.[132] Therefore, changes to the wording of paragraphs 5 and 6 are needed.[133]

Paragraph 5 provides an alternative test to ascertain whether a PE of a company exists in the given state. A company should be regarded as having a PE in a state, even without physically being present there, in case a person acts for it. Persons, who act on behalf of a company and do not do so in the course of exercising business as an independent agent, fall within the scope of Article 5(5) OECD MTC. The fifth paragraph, however, proceeds only on the basis that such person habitually concludes

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[129] BEPS Action 7, p 28.
[130] Ibid, pp 9-10.
[131] Ibid, p 10.
[132] Ibid, p 15.
[133] Note: low-risk distributor arrangements are not addressed under Action 7 but Action 9.

contracts in the name of the company or habitually plays the leading role in their conclusion. The agent's actions are more than a mere promotion or advertisement. Moreover, such activities take place repeatedly on a regular basis. For paragraph 5 to apply, three conditions must be met. First of all, the person acts on behalf of the company. Next to this, the person habitually and routinely concludes contracts on behalf of this company. In this regard, no precise frequency test exists to determine the habitualness. Last but not least, the contracts are either entered into in the name of the company or for the transfer of ownership of property belonging to the company. If these requirements are met, a permanent establishment of the company exists. It is obvious that within the real economy contracts are often signed online. Hence, the current wording 'conclude contracts' of Article 5(5) OECD MTC was outdated and was replaced by the wording 'contracts in the name of'.[134]

Classical examples of such a relationship can be found in cases where an agent acts for a principal, where a partner acts for a partnership, where a director acts for a company or where an employee acts for an employer.[135] It also clearly applies to digital businesses. The illustrative case can be pointed out where company A distributes its products worldwide through its website. Its subsidiary B located in state X is responsible for calling, visiting and convincing the customers to buy the products. B's employees thus play the principal role leading to the conclusion of the contracts between A and the consumers. Hence, A would be deemed to have a PE in state X.

Paragraph 5 will not apply in case the activities performed by the agent are covered by the exception in Article 5(6) OECD MTC or if such activities are of mere preparatory or auxiliary character.[136] Along, the profits attributable to a PE resulting from the application of Article 5(5) OECD MTC will be determined and governed by the rules under Article 7 OECD MTC.[137]

According to paragraph 6, a company employing an independent agent carrying on business as such, cannot be taxed in this state. The activities of an agent acting in the ordinary course of his business, representing a separate and independent company, do not result in a PE of the foreign company. This independent status is less likely to exist

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[134] OECD, 'Preventing the Artificial Avoidance of PE Status: Public Discussion Draft' (OECD Publishing 2015), pp 11 ff.

[135] BEPS Action 7, pp 17-18; Commentary on Article 5, paras 31-32.

[136] BEPS Action 7, p 18; Commentary on Article 5, para 32.2.

[137] BEPS Action 7, p 23; Commentary on Article 5, para 35.1.

if the activities are exclusively performed on behalf of the foreign company or closely related enterprises. The independence of the agent depends on the obligations which he has vis-à-vis the company and on the entrepreneurial risk he bears. If the agent is subject to detailed instructions or exhaustive control by the company, he cannot be regarded as independent. An independent agent will usually be responsible for the results of his work and decides himself how to carry out his work. The agent may be required to provide the principal with information related to the business, which is simply intended to ensure a smooth running of their agreement. It does not necessarily mean, therefore, that the agent depends on the company. Nevertheless, for each situation all facts and circumstances need to be analyzed individually.[138] Modifications have been adopted with respect to situations in which the agent can no longer be regarded as independent but rather closely related to the enterprise. As a consequence, a person is closely related to an enterprise if one controls the other or both are under the control of the same person or enterprise. In any case, if more than 50% of the beneficial interest is owned in either of the two, by one of them or a third person in both, a person is considered to be closely related to the company.[139]

4.3. Profit attribution to PEs

Once it is established that a PE exists, it does not mean that the entire profits resulting from the performance of these contracts should be attributed to it. Attribution of profit issues focus on whether the existing rules under Article 7 OECD MTC are sufficient and appropriate to determine the profits allocated to PEs. The BEPS Action Plan concluded that no substantive modifications are required, but that an additional guidance on how to approach profits resulting from a PE in the light of Article 7 OECD MTC is needed. Especially Actions 8-10 dealing with transfer pricing issues need to be taken into account.[140]

Activities performed by other enterprises, to which the PE belongs, have to be properly remunerated, so that the profits attributed to the PE are only those that it would have derived if it were a separate and independent enterprise. In relation to this, the arm's length reward for the services of the intermediary needs to be correctly determined and deducted in the calculation of the profits attribution under Article 7 OECD MTC. Additionally, Article 9 OECD MTC becomes relevant as it embodies the arm's length

[138] BEPS Action 7, pp 23-25; Commentary on Article 5, paras 36-37.
[139] BEPS Action 7, pp 25-26.
[140] Ibid, p 45.

principle, which is equally contained in the OECD Transfer Pricing Guidelines. Neither the OECD MTC, nor the commentary or actions clarify whether a profit adjustment under Article 9 OECD MTC should precede the attribution of profits under Article 7 OECD MTC.[141]

4.4. Multilateral Anti-BEPS Convention (MLI)

In November 2016, the OECD published the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). The MLI has been open for signing since December 31, 2016. It is up to the member states whether to implement the BEPS measures relating to Action 7 via the MLI or otherwise. The MLI incorporates the relevant provisions in its Articles 12 to 15.[142]

5. Steps taken by the European Commission to address tax issues raised by the digital economy

The Digital Single Market (DSM), one of the Commission's priorities, needs a modern and stable tax framework to ensure certainty and business opportunities. Commission President Jean-Claude Juncker emphasized in his 2017 State of the Union Address that the Commission calls for fair taxes for the digital industry.[143] It is essential that EU businesses grasp the opportunities arising from the digital economy to remain competitive and to be able to scale up quickly. Accordingly, the Commission has taken action to make sure that all businesses operating in the EU should pay their taxes where profits and value are generated.[144] The Anti-Tax Avoidance Package provides concrete measures, such as a Directive, to prevent aggressive tax planning, boost transparency and provide a greater level playing field in the EU. Furthermore, the Commission returned and refined its proposals for further two Directives on common corporate tax bases. Lastly, the sections below will shortly address whether the modification of the

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141 OECD, 'BEPS Action 7 Additional Guidance on Attribution of Profits to Permanent Establishments: Public Discussion Draft' (OECD Publishing 2017), paras 8-12.

142 Maarten de Wilde, 'Lowering the Permanent Establishment Threshold via the anti-BEPS Convention: Much Ado About Nothing?' (2017) 45 Intertax 8/9, pp 556-567.

143 European Commission, 'President Jean-Claude Juncker's State of the Union Address 2017' (Speech 2017) <https://www.google.de/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=0ahUKEwjjoMGAk8LbAhWRa1AKHQ4uCpsQFgg3MAE&url=http%3A%2F%2Feuropa.eu%2Frapid%2Fpress-release_AGENDA-17-2321_en.pdf&usg=AOvVaw0tIEaRt7pFzpf_HX4pL8Eu> accessed 20 June 2018.

144 European Commission, 'A fair and efficient tax system in the European Union for the Digital Single Market' (COM 2017 547 final), pp 2-4.

PE status would run counter fundamental freedoms, state aid rules and already existing secondary law.

5.1. Anti-Tax Avoidance Package

The European Commission adopted the Anti-Tax Avoidance Package in January 2016. The background for its introduction includes, amongst others, the annual lost tax revenues for the EU estimated at between 50 and 70 billion euro.[145] It aims at combatting tax avoidance and aggressive tax planning by imposing greater transparency requirements on MNEs and by obliging more information sharing among Member States (MS).[146] Next to this, it guarantees a coordinated stance in the implementation of the BEPS project.[147] The package is based on a three-pillar approach. These three aims entail effective taxation, tax transparency and addressing the risk of double taxation. The package is composed of four documents, including the Anti-Tax Avoidance Directive (ATAD), the Communication on an External Strategy for Effective Taxation, the amendment to the Directive on mutual assistance to apply automatic exchange of information to country-by-country reporting, and the recommendation on tax treaties adding the 'genuine economic activity' test to the Principal Purpose Test.[148] The package acknowledges that there is no single international standard but rather coexisting national interests on tax policy, competition and protectionism.[149] Hence, the package represents a step in the direction of further harmonization of profit taxes.

The ATAD sets out key anti-avoidance measures related to the deductibility of interest (Article 4), exit taxation (Article 5), a switch-over clause (Article 6), a general anti-abuse rule (GAAR) (Article 7), CFC rules (Articles 8 and 9) and a framework to tackle

[145] European Commission, 'Commission Staff Working Document Accompanying the Document Communication from the Commission to the European Parliament and the Council – Anti Tax Avoidance Package: Next Steps towards delivering effective taxation and greater tax transparency in the EU' (SWD 2016 6 final, COM 2016 23 final), p 6; The working document refers for some substantiation to Robert Dover and others, 'Bringing transparency, coordination and convergence to corporate tax policies in the European Union Part I: Assessment oft he magnitude of aggressive corporate tax planning' (2015) Study for the European Parliamentary Research Service.

[146] European Commission, ' Tax transparency: Commission welcomes agreement reached by Member States for the automatic exchange of information on country-by-country reports (CbCR) of multinational companies, subject to UK scrutiny' (Press release 2016), p 1.

[147] Claus Staringer, 'Die Anti-Tax-Avoidance-Richtlinie: Gesamtwürdigung aus steuer-politischer Sicht' in Josef Schuch and others, *Die Anti-Tax-Avoidance-Richtlinie: Schriftenreihe zum Unternehmenssteuerrecht* (Linde 2017), p 3.

[148] European Commission, 'Commission Recommendation of 28.1.2016 on the implementation of measures against tax treaty abuse' (COM 2016 271 final).

[149] Ana Dourado, 'The EU Anti Tax Avoidance Package: Moving Ahead of BEPS?' (2016) 44 Intertax 6/7, p 440.

hybrid mismatches (Article 10). The Commission, in particular tax commissioner Pierre Moscovici, recommends that MS should adopt the new provisions of Article 5 OECD MTC to target the artificial avoidance of PE structures.[150] In principle, the ATAD requires transposition until the end of 2018.[151] In fact, the ATAD was the second choice only, as the delay in the approval of the CCCTB Directive had to be overcome. Some provisions of the directive go beyond the BEPS final reports, raising suspicion and criticism.[152]

The External Strategy for Effective Taxation requires a minimum level of taxation in third countries, intending a common approach to EU good governance standards. Ultimately, it would lead to the promotion of EU outbound investment and an increase of the fair tax competition level of the EU globally. Third countries will be required to refrain from harmful tax measures with regard to business taxation. Difficulties arise with the characterization of 'developing countries' for the purpose of the package.[153]

On the one hand, a *de minimis* approach on a European level would continue to promote legal uncertainty, disparities and double taxation, respectively double non-taxation. On the other hand, a *de maximis* approach would not receive the necessary support by which the EU would miss its chance to be at the forefront of the anti-BEPS movement. Consequently, a mixture of a *de minimis* approach and simple coercive rules would currently seem to be the best fit.[154]

5.2. Revival of the CCTB and CCCTB

In 2016, the Commission re-launched the proposal of two directives on a Common Corporate Tax Base (CCTB) and a Common Consolidated Corporate Tax Base (CCCTB). The proposals intend to maintain a fair taxation where profits are generated. These measures envisage establishing common rules for corporate taxes and introducing a system in which companies can submit a single consolidated tax declaration for their activities to the tax authority in one MS only.[155]

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[150] Heather Corben, ' The European Commission's anti-tax avoidance package' (Tax Journal 2016), pp 2-4 <http://www.kwm.com/~/media/library/Files/PDF/2016/03/kwm-tax-journal-european-comissions_anti-tax-avoidance-package.ashx?la=en> accessed 20 June 2018.

[151] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] OJ L193/1, Article 11(1).

[152] Ana Dourado, 'The EU Anti Tax Avoidance Package: Moving Ahead of BEPS?' (2016) 44 Intertax 6/7, p 442.

[153] Ibid, pp 443-444.

[154] Ibid, p 445.

[155] Udo Bux, '''Effective Corporate Tax Rate'' and ''Digital Business Establishment'' in the Corporate Tax Base Proposals' (2017) European Parliament Briefing, pp 1-2.

The CCTB lays down common corporate tax rules for computing the tax base of companies and PEs. According to this directive, all revenues will be taxable unless expressly exempted, providing for a very broad tax base. Deductions will be made available to small and medium-sized enterprises (SMEs), which are particularly innovative.[156] Once the common base is secured, consolidation would come into play. The Commission continues to believe that the CCCTB provides an EU framework for revised PE rules. Hence, the CCCTB aims at an EU-wide corporate tax system with cross-border consolidation of the tax results within a group. The Commission proposal was intended to be mandatory for groups beyond a consolidated turnover above 750 million euro. These MNEs are most likely to engage into aggressive tax planning and into the attempt of large-scale tax avoidance. A single European tax administration, corresponding to the residence state of the parent company, will be in charge for the entire group.[157] As a result, double taxation would be removed. Additionally, companies would be stopped from exploiting loopholes between MS, namely hybrid mismatches.[158] Corporate tax rates are not touched by the CCCTB, as these remain within the national sovereignty of the MS. Nevertheless, the Commission is convinced that the proposal would create a more transparent, efficient and fair system for calculating the tax base of multinational companies.[159]

5.3. Further miscellaneous considerations from an EU law perspective

In drafting Community measures, the Commission has to make sure that essential principles arising from the treaties and case law are abode with. In the past, the EU institutions have been active in the field of taxation. In particular, the fundamental freedoms, the state aid principles and previously adopted secondary legislation deal with tax issues and allow for the amendment of Article 5 OECD MTC.

5.3.1. Fundamental freedoms

Despite the Commission's efforts, it is settled case law of the European Court of Justice (ECJ) that 'the disadvantages which could arise from the parallel exercise of tax competences by different Member States […] do not constitute restrictions on the

[156] European Commission, 'Commission Proposal for a Council Directive on a Common Corporate Tax Base' (COM 2016 685 final), pp 2-10.
[157] European Commission, 'Commission Proposal for a Council Directive on a Common Consolidated Corporate Tax Base' (COM 2016 683 final), pp 3-8.
[158] Ibid, Article 74.
[159] European Commission, 'Commission proposes major corporate tax reform for the EU' (Press release 2016), p 2.

freedom of movement' and thus 'Member States are not obliged to adapt their own tax systems to the different systems of tax of the other Member States in order, inter alia, to eliminate double taxation'.[160] However, the ECJ has further held that MS retain the possibility to seek guidance on how to allocate their taxing rights from 'the criteria followed in international tax practice'.[161] Against this background, the eventual extension of the PE status does not give rise to an infringement of any of the fundamental freedoms.

5.3.2. State aid

The prohibition of fiscal state aid under Article 107 of the Treaty on the Functioning of the European Union (TFEU) does not impede the reform of the PE status.[162] The condition of selectivity is an important requirement for the existence of state aid, according to which a measure has to favor certain undertakings or the production of certain goods in comparison with competitors in a comparable legal and factual situation.[163] The modification of the PE concept would not lead to selective tax benefits and would apply to all business sectors.[164]

5.3.3. Existing secondary EU law on PEs

The current *acquis communautaire* on direct taxes would not have to be changed as a result of the amendment of Article 5 OECD MTC. The PE definitions entailed in Article 2(b) of the Parent-Subsidiary Directive (PSD) and in Article 3(2) of the Interest and Royalties Directive (IRD) can be understood as not to include exceptions for preparatory and auxiliary activities.[165]

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[160] Case C-513/04 *Kerckhaert and Morres* [2006] EU:C:2006:713, paras 19, 20 and 24; Case C-157/*10 Banco Bilbao Vizcaya Argentaria* [2011] EU:C:2011:813, paras 38-39.
[161] Case C-157/10 *Banco Bilbao Vizcaya Argentaria* [2011] EU:C:2011:813, para 31; With reference to Case C-336/96 *Gilly* [1998] EU:C:1998:221, paras 24 and 30.
[162] Article 107 TFEU.
[163] Case C-311/08 *SGI* [2010] EU:C:2010:26, paras 50 ff.
[164] Joachim Englisch, 'BEPS Action 1: Digital Economy – EU Law Implications' (2015) British Tax Review, p 8.
[165] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (recast) [2011] OJ L345/8; Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49; Joachim Englisch, 'BEPS Action 1: Digital Economy – EU Law Implications' (2015) British Tax Review, p 12.

6. Alternatives to the concept of PE?

As the PE concept under the OECD MTC always supposes a certain degree of physical presence, even after the introduction of the Action Plan, the proposals will probably fail to solve the tax challenges arising from the digital economy. Some countries introduced initiatives and laws to directly tax digital businesses, instead of applying the classical model of PEs.[166] Four alternatives will be taken into consideration in the following sections.

6.1. New concept of nexus

A new nexus based on significant economic presence would create a taxable presence in a country where a non-resident company sustainably and regularly interacts with the economy of that country via technology or other digital means and tools, without having an actual physical presence there.[167]

Generated revenue is most likely the clearest indicator of the existence of a significant economic presence. However, it would not be sufficient to establish a nexus alone. Nevertheless, it limits compliance costs of taxpayers and provides a high degree of certainty for cross-border transactions. A possible approach could be to only include revenues arising from digital transactions concluded with customers within a country through the company's digital platform. The gross amount of revenues generated should be framed in absolute terms and in the local currency. An aggregation rule could be introduced as a rebuttable presumption for the taxpayer. He would have to demonstrate that no artificial fragmentation of the distance selling activities took place in order to manipulate the threshold. A mandatory registration system could be established where any company meeting the criteria for a significant economic presence would be registered.[168]

Other factors could be based on a more digital presence, such as a local domain name, helping the MNE to protect its trademarks and to facilitate doing business. Moreover, a local digital platform, such as websites, offering the goods or services to local customers in the local language and in accordance with the cultural standards and terms of service could serve as another useful indicator. Next to this, local payment options

[166] Jean-Louis Medus, 'Digital Business and Permanent Establishment (some critical comments of BEPS' proposals to regulate digital business)' (2016), p 19 <https://www.archers.fr/wp-content/uploads/2016/12/Vdef-BEPS-and-PE-Journal-of-international-Taxation.pdf> accessed 20 June 2018.

[167] BEPS Action 1, p 107.

[168] Ibid, pp 107-108.

with prices reflected in the local currency, taxes, duties and fees already calculated and the option of using a local payment service add to the existence of a presence.[169]

Given the importance of network effects in the digital economy, a range of factors based on users could be applied to reflect the level of participation in the economic life of a country. The number of monthly active users (MAU) could be taken to refer to the registered users visiting the company's website on a 30-day basis. By implication, the customer and user base in a given country could be measured both in size and level of engagement. Another factor could be the regular conclusion of online contracts. The dependent agent test under Article 5 OECD MTC requires that this contract be concluded in a country by a person acting on behalf of the non-resident company. The decisive aspect would be the number of contracts concluded in the taxable year. Additionally, the volume of digital content collected from users and customers in that country via the digital platform could equally be used as an indicator.[170]

The choice of combination of the various factors with the intent to ascertain a significant economic presence is likely to be dependent on the different features and attributes of each market.

The International Bureau of Fiscal Documentation (IBFD) proposed a new PE nexus concept in 2015, directly relating to Action 1 of the BEPS project. The proposal supports the introduction of a new Article 5(8) OECD MTC with the following wording:

> If an enterprise resident in one Contracting State provides access to (or offers) an electronic application, database, online market place or storage room or offers advertising services on a website or in an electronic application used by more than 1,000 individual users per month domiciled in the other Contracting State, such enterprise shall be deemed to have a permanent establishment in the other Contracting State if the total amount of revenue of the enterprise due to the aforementioned

[169] Ibid, p 109.
[170] Ibid, p 110.

services in the other Contracting State exceeds XXX (EUR, USD, GBP, CNY, CHF, etc.) per annum.[171]

Consequently, the framework requires four conditions to be fulfilled, namely digital services, user threshold, time threshold and *de minimis* revenue threshold. The IBFD emphasizes that it should not be decisive whether the digital service presents a main or incidental part of the business of the enterprise.[172] This would mean that Article 5(4) OECD MTC could be deleted. It would also presuppose a stronger reliance on the sourcing theory to help establish the nexus with the taxing jurisdiction in which business income is generated and value creation occurs. Similarly, it is useful to take into consideration the benefit theory, according to which a business may receive certain benefits from the state of residence of the customer, such as the legal system, the enforcement of payments, the protection of IP rights, infrastructure and others. Therefore, this state should not be prevented from taxing the business in order to counterbalance the cost borne to provide these services.[173] The proposal stipulates that a PE nexus exists whenever the digital or physical presence of a company in a country gives rise to value creation, combining the source and benefit theory. Nevertheless, the comments during the public consultation on BEPS Action 1 remained critical towards the introduction of a new nexus. First, the standard of 'significant digital presence' could create distortions through the existence of a separate tax regime being applicable only to the digital economy. Second, it would be a difficult task to determine the attributable and taxable income, as digital business operations would be compared to traditional business operations for the determination of appropriate margins.[174]

6.2. Attribution of profits based on significant economic or digital presence

Another possible approach could be to apportion the profits of a company to the digital presence on basis of a predetermined formula or on basis of different allocation factors chosen on a case-by-case basis. Certain countries like Saudi Arabia established such concept of virtual permanent establishment based on the United Nations Tax Model.[175]

[171] Peter Hongler and Pasquale Pistone, 'Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy' (2015) WU International Taxation Research Paper Series No. 2015-15, p 3.
[172] Ibid, pp 3-4.
[173] Ibid, p 22.
[174] Association Française des Femmes Fiscalistes, 'Comments Received on Public Discussion Draft, BEPS Action 1: Address the Tax Challenges of the Digital Economy' (OECD Publishing 2014), p 3.
[175] Jean-Louis Medus, 'Digital Business and Permanent Establishment (some critical comments of BEPS' proposals to regulate digital business)' (2016), p 19 <https://www.archers.fr/wp-

A fractional apportionment method would first require a definition of the tax base to be divided, then the determination of the allocation factors and lastly, the weighting of these factors. However, such approach would be a departure from the current international standards and would produce dissimilar tax results with regard to different business concepts. It would equally contradict the EU law principle of free movement of services.[176] On the other hand, an empirical presumption method would determine the deemed net income by applying a ratio of presumed expenses to the non-resident MNE's revenue derived from transactions with in-country customers. Again, such method would depart from current international perceptions and would be relatively difficult to administer having regard to large MNE groups with complex operating structures. Moreover, it would be possible to incur tax liability even in the absence of actual profits generation through an economic presence.[177]

6.3. Withholding tax

Various countries, like Luxembourg and the Netherlands, have introduced initiatives and effective laws targeting to tax digital businesses via the so-called Google tax.[178] Such withholding tax would be levied on payments by residents for the goods and services purchased online from a non-resident provider. The application of this withholding tax on digital transactions could be considered a tool to enforce compliance with net taxation based on the new nexus described above. The scope of transactions would have to be clearly defined, so that taxpayers know when the tax applies. However, it could lead to differences in treatment for tax purposes between economically equivalent transactions. The agent responsible for withholding must have access to information about the transactions to know when the tax will apply. The system could be facilitated by adding a mandatory registration system for non-resident companies. Related to this, enforcing the collection of minute amounts of withholding from large number of consumers would involve considerable costs and administrative challenges. The withholding tax rate would have to be set at a low amount in order to reduce the negative impact of an imperfect proxy in net income.[179]

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content/uploads/2016/12/Vdef-BEPS-and-PE-Journal-of-international-Taxation.pdf> accessed 20 June 2018.

[176] Article 56 TFEU; Paul Craig and Grainne de Burca, *EU Law: Text, Cases, and Materials* (6th edn, OUP 2015), pp 820-824.

[177] BEPS Action 1, pp 111-113.

[178] Ibid, p 21.

[179] Ibid, pp 113-114.

In April 2015, the UK introduced the diverted profits tax (DPT).[180] The tax is imposed on diverted profits at a rate of 25% in order to counter the artificial erosion of the British tax base and to subject profits to tax if a MNE is economically active in the UK and has substantial sales there. This anti-abuse measure avoids the circumvention of the PE classification and therefore, establishes a nexus in the market jurisdiction.[181]

The IBFD proposed a global standard withholding tax of 10% on all base-eroding business payments to registered non-residents with certain exemptions. Payments to unregistered payees would be subject to a higher withholding tax of 15%.[182] According to the IBFD, a final withholding tax is a 'second-order alternative to the nexus-based solution', as presented in section 6.1.[183] The proposal foresees that every business-deductible payment would be subject to a withholding tax, unless a qualified exemption code is presented to the payor by a registered enterprise. This system intends to satisfy the taxation of income that may entirely escape taxation, but does not however realign the revenue division mechanism.[184] The incorporation of a new Article 7(4) OECD MTC would provide:

> Payments made by an enterprise of a Contracting State or by a permanent establishment situated in a Contracting State may be taxed in that State. The tax so charged shall not exceed:
> (a) 10 per cent of the gross amount of the payments if the payee is an enterprise of the other Contracting State or a permanent establishment situated therein duly registered with the first-mentioned Contracting State for the purposes of this paragraph; and
> (b) 15 per cent of the gross amount of the dividends in all other cases.
> The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this tax, including specified exemptions for non-base eroding and other similar payments.[185]

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[180] Finance (No 2) Act 2015.
[181] Maarten de Wilde, 'Tax jurisdiction in a digitalizing economy: why 'online profits' are so hard to pin down' (2015) Intertax 12, p 800.
[182] Andres Baez and Yariv Brauner, 'Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy'(2015) WU International Taxation Research Paper Series No. 2015-14, p 2.
[183] Ibid, p 6.
[184] Ibid, p 14.
[185] Ibid, p 23.

Most importantly, the imposition of a final withholding tax on foreign suppliers for remote sales is likely to conflict with trade obligations and European Union law. On an international basis, it is likely that the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade and Services (GATS) would apply. Both agreements require foreign suppliers of goods and services to be taxed no less favorably than domestic suppliers. Even though the GATS provides for exceptions (unlike GATT), consideration would need to be given to ways to preserve national treatment.[186] EU law imposes comparable obligations. The principle of non-discrimination between resident and non-resident businesses would not permit the application of such withholding tax.[187]

6.4. Equalization levy

An equalization levy could be considered an alternative to overcome inconsistencies in the attribution of income, addressing the broader tax challenges of the digital economy. It would ensure an equal treatment of foreign and domestic suppliers. An equalization levy would render it possible to tax non-resident enterprises with a significant economic presence in a country, but only in case where it is determined that such presence exists. Such levy could be applied to all transactions concluded remotely with in-country consumers or could be limited to transactions involving automated systems of contracting through a digital platform. Nevertheless, it must be borne in mind that limiting the scope of application too narrowly would limit flexibility of such levy with regard to future innovation and development. The levy could be imposed on data of customers or on the average number of MAU, both representing a great challenge in the execution.[188] Countries like India decided to implement an equalization tax that would be charged on fees by advertisers.[189]

Nevertheless, the same income risks being subject to both corporate income tax and the levy. Hence, it would be necessary to structure the levy to apply only to situations in which income would otherwise be untaxed or subject to a low rate only. Alternatively, the levy could be credited against the domestic corporate tax.[190]

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[186] General Agreement on Tariffs and Trade 1994; General Agreement on Trade in Services 1995.

[187] Article 18 TFEU; Case C-196/04 *Cadbury Schweppes* [2006] EU:C:2006:544, para 51.

[188] BEPS Action 1, pp 115-116.

[189] Ina Kerschner and Maryte Somare, *Taxation in a global digital economy: Schriftenreihe IStR Band 107* (Linde 2017), p 152.

[190] BEPS Action 1, p 117.

Similar to the withholding tax, an equalization levy on non-resident companies would run against trade agreements and EU law obligations.[191] The OECD, therefore, renounced to explore this option.

7. Conclusion

The digital economy is increasingly becoming the economy itself. Therefore, attempting to isolate it as a separate sector would require arbitrary lines to be drawn between what is digital and what is not.[192] The digital economy supposes and allows a split of functions and the fragmentation of assets among different countries. The Internet is still in its infancy and will expand in ways that are impossible to predict. The brick-and-mortar businesses have been replaced by click-and-mortar businesses. Therefore, any reform should be broad enough so that it does not target single technical developments associated with the Internet. The best approach would be to develop broad tax rules that can be directed at economic activities generated by both digital and traditional businesses. Companies without substantial digital presence may have global brands, know-how and other intangible values that raise similar tax issues.[193] This phenomenon can be perceived in the case of Amazon. Although the company's doubtful business structure and tax policy have become public and attracted much criticism, it nevertheless won the case against the IRS in the US and also escaped from further obligations in the UK. It shows that ring-fencing the digital economy is not an option. In fact, the overall economy is becoming increasingly digital, rendering specifically designed rules inappropriate. However, on the other hand, dismissing any suggestions for reform of the current system, by employing the 'it will never happen' attitude, cannot be accepted either. It was not all that long ago that people thought likewise about bank secrecy laws or the automatic exchange of financial information.

BEPS Action 1 dealing with tax challenges of the digital economy foresees to reduce the existence of gaps enabling a reduction of taxable income and the shifting of profits to favorable tax regimes by MNEs. The use of newly developing business models based on intangible assets, makes it practically impossible to establish a sufficient connection between business operations and jurisdictions. This presents an incentive for big players

[191] GATS, GATT, TFEU.
[192] BEPS Action 1, p 54.
[193] Arthur Cockfield, 'BEPS and Global Digital Taxation' (2014) 75 Tax Notes International 11, p 938.

on the market to implement various tax avoidance practices, as outlined above in section 3.2. However, no concrete recommendations or solutions have been submitted by BEPS Action 1. The TFDE rather anticipates that the measures of Action 2 to 15 lead to a substantial reduction of tax avoidance and profit shifting.[194] Hence, amongst others, BEPS Action 7 tries to mitigate these international tax problem areas. The concept of PE under the OECD MTC relies on physical presence and does not catch websites or other online structures. Within the digital economy, the PE status is often artificially avoided. MNEs regularly exploit the exemptions provided under Article 5(4) OECD MTC, which are limited to preparatory and auxiliary functions. Nevertheless, activities classified as such increasingly represent core business functions of companies. By restricting each exception to this criterion and introducing an anti-fragmentation rule, the OECD aims at combatting PE avoidance. Changes to commissionaire arrangements included the recognition of the fact that nowadays contracts are often concluded online and that, therefore, the wording has to be correspondingly adapted to cover digital businesses. Moreover, modifications have taken place with regard to agents, which can no longer be considered as independent. The amended PE concept under BEPS Action 7 will have limited impacts on digital business since physical presence is still prevalent despite its irrelevant role for online marketplaces and websites. The amendments relating to Article 5 OECD MTC will have little effects on businesses operating within the realm of the digital economy, as mostly businesses active in e-commerce will be affected. E-commerce, however, has a much narrower scope than the digital economy in its whole.[195] This narrow impact highlights that the digital economy remains a problem for source states in a post-BEPS business world. The revised PE rules have done little to achieve a new universal PE concept. In fact, even though the BEPS actions are meant to reduce gaps and disparities, their unilateral implementation will lead to different national measures being enacted, and hence new disparities. Because the OECD is a soft law organization, it remains to implement BEPS recommendations via changes in domestic laws and practices via treaty provisions. It is always possible to have Action 7 implemented bilaterally between the countries. The recently concluded tax treaty between Australia and Germany or that between Chile and

[194] Matthias Mitterlehner, 'Gewinnverlagerung und Steuervermeidung in der Digital Economy' (2016) 2 SWI, p 66.
[195] Atanas Atanasov, 'Permanent establishment 2.0 – is it time for an update?' (2017), p 22.

Japan are examples of a voluntary adoption of Action 7.[196] It has to be borne in mind that the world's largest economy, the US, has refused to agree to and adopt the new standard. First and foremost, the implementation will take the form of a multilateral instrument, which seeks to override approximately 3,000 tax treaties worldwide. A multilateral agreement to amend bilateral treaties seems to be a very radical measure to achieve the aims of the Action Plan. Many states have signed the multilateral instrument, however, only few adopted it, illustrating the ambivalence over the new standard.[197] The lack of common consensus among states, particularly between developed and developing economies, surmises that it will not be feasible to tackle the problem of the digital economy and PEs via this route.

As can be discerned from the aforementioned, the EU has acknowledged that it is vital for EU companies to take opportunities arising in the digital market to remain competitive. The Commission proposed concrete measures to ensure that taxes are paid where profits and value are created. Simultaneously, this Anti-Tax Avoidance Package functions as implementing measure of the BEPS project. The most prominent efforts constitute the ATAD and the two directive proposals on common corporate tax bases. The package of the EU concedes that no international standard exists, but rather coexisting national interests and tax policies, which seems to be a more realistic view than that taken by the OECD.

A possible solution could consist in a suitable definition of transfer pricing, but it would impose a common definition of digital business and of the process of value creation in the digital economy. Remarkable steps have been taken by those countries implementing alternative measures, as those advanced in chapter 6. An equalization levy and a new way of attributing profits do not convince as such, since concerns of international and EU law obligations are raised. The same is true for the proposed withholding tax, which would otherwise be a very attractive and feasible option, especially in combination with a new nexus approach. Notwithstanding, the possibility of a new nexus concept is not only viable in practice but also renders a real and actual solution to the problem of taxing the digital economy. The question arises whether the

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[196] Ibid, p 64.

[197] Mindy Herzfeld, 'The Multilateral Instrument and Permanent Establishments' (2017) 86 Tax Notes International, p 1029.

alternative proposals, which some countries have adopted in their jurisdiction, hinder the progress of the BEPS Action Plan rather than support it. In any case, it is without doubt that all these actions will further assist the countries in preventing tax evasion and in regulating the digital economy; a task, which will unlikely, be mastered by the OECD Action Plan. Its attempt to avoid tax avoidance and the circumvention of the PE status will potentially be successful only to some extent. At last, however, it will at best bring about some coherence, but no real harmonization of tax laws.

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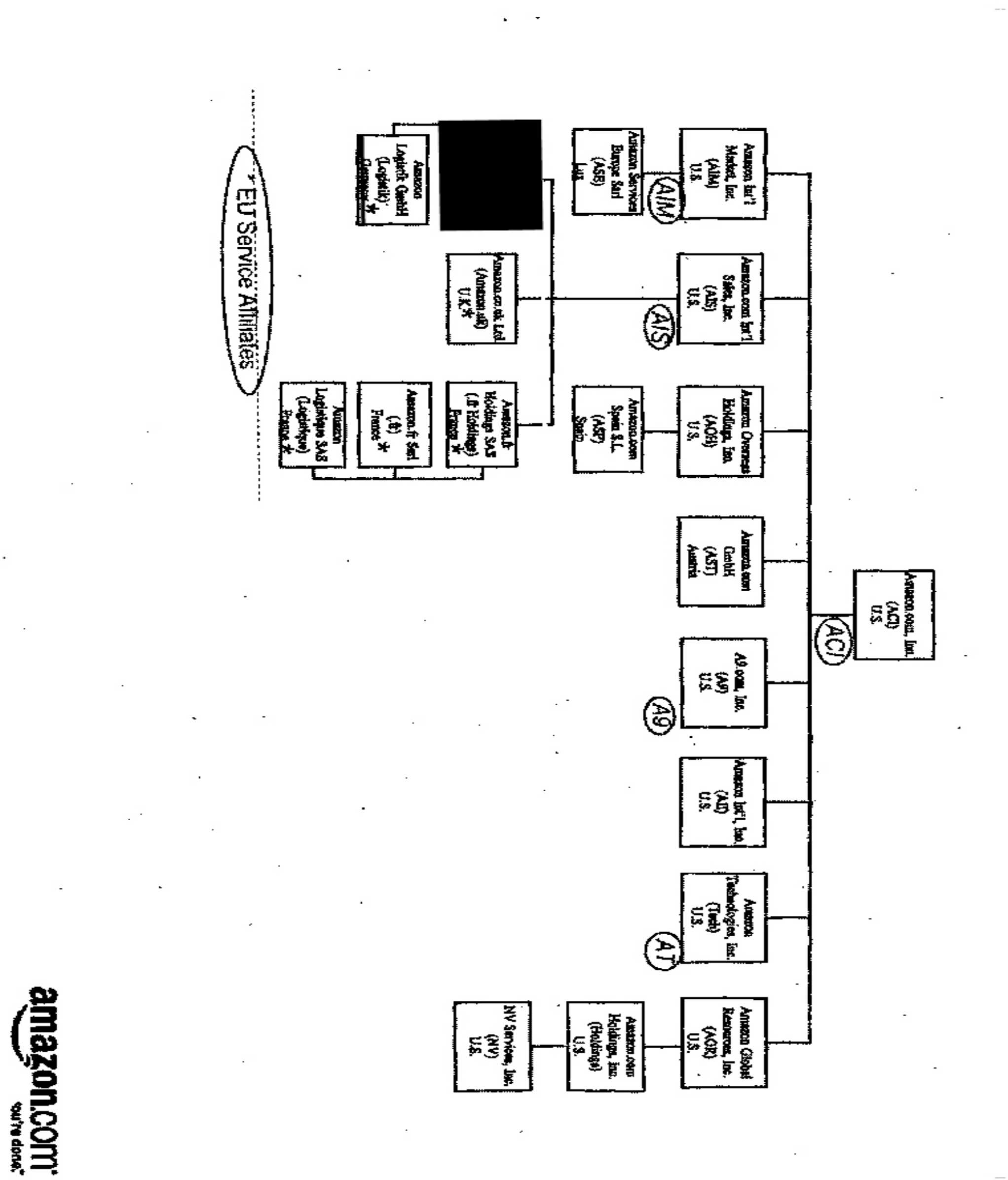
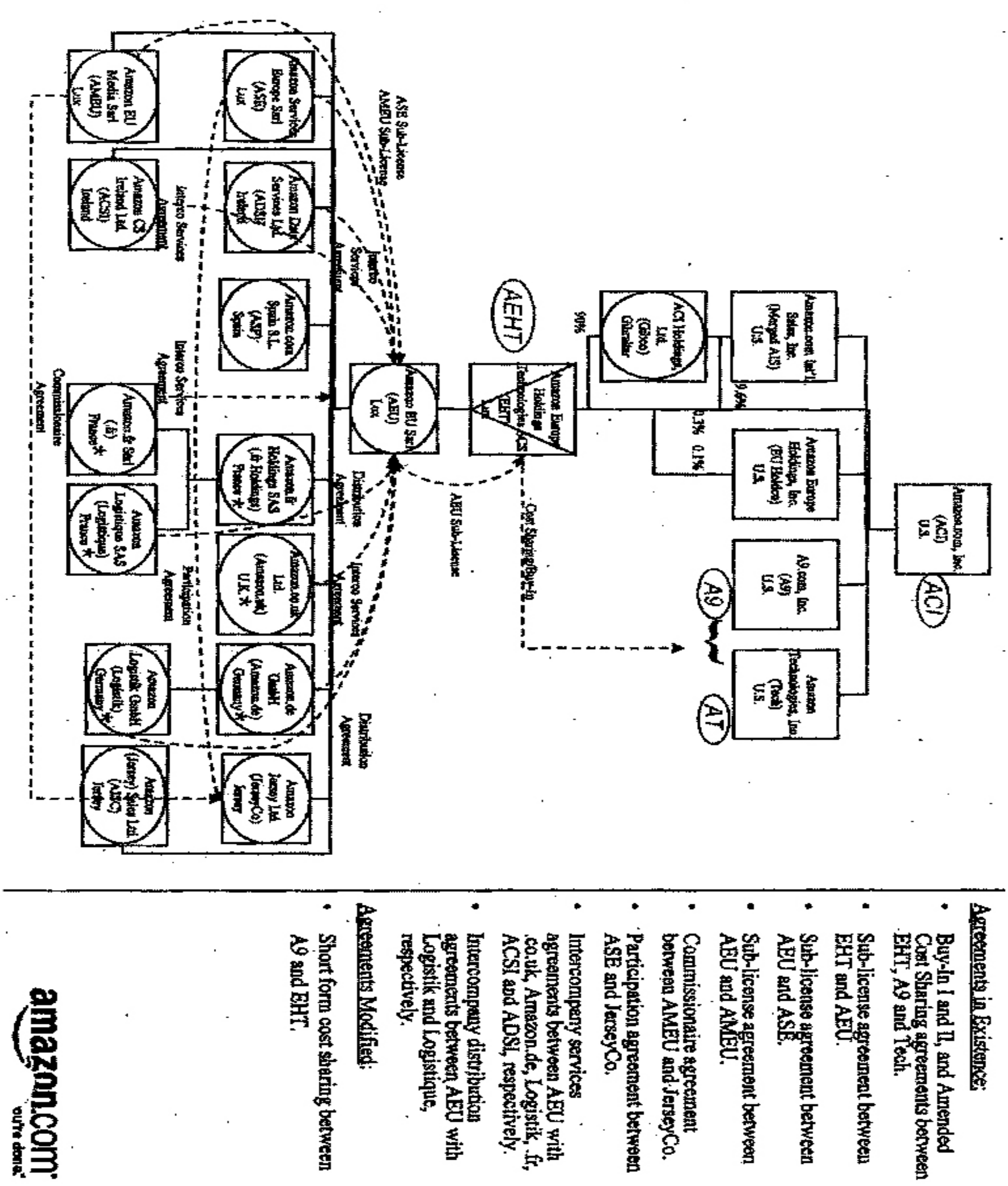
9. Annexes

9.1. Annex A – Amazon structure before Project Goldcrest



Source: theguardian.com, retrieved from https://www.theguardian.com/technology/2016/feb/18/revealed-project-goldcrest-amazon-avoid-huge-sums-tax

9.2. Annex B – Amazon structure after Project Goldcrest



Source: theguardian.com, retrieved from https://www.theguardian.com/technology/2016/feb/18/revealed-project-goldcrest-amazon-avoid-huge-sums-tax

9.3. Annex C – English abstract

Digitalization is a growing phenomenon of our modern economy. However, the tax framework in place today was designed for the traditional economy and is unable to capture activities, which are increasingly based on intangible assets and data. The brick-and-mortar businesses have been replaced by click-and-mortar businesses. The digital economy supposes and allows a split of functions and the fragmentation of assets among different countries. This cross-border dissemination of assets and fragmentation of activities through treaty shopping allow multinational digital companies to avoid the setting up of permanent establishments and thus taxation. The main part of their profits is attributed to jurisdictions with favorable tax regimes, such as Luxembourg.

In the early 2000's, Amazon set up operations in Luxembourg to radically reshape its tax structure. The largest online retailer managed to shift vast amounts of its profits by using a complex patchwork of subsidiaries, exposed as the Project Goldcrest. As the company's secret business success was revealed, the landmark case between the Inland Revenue Service and Amazon could have resulted in a huge fine. Although the company's doubtful business structure and tax policy have become public and attracted much criticism, it nevertheless won the case against the IRS in the US and also escaped from further obligations in the UK. Additionally, Amazon is under state aid investigations in the EU, where the Commission suspects Luxembourg of having granted unfair tax advantages to the company.

This shows that ring-fencing the digital economy is not an option. In fact, the overall economy is becoming increasingly digital, rendering specifically designed rules inappropriate. However, on the other hand, dismissing any suggestions for reform of the current system, by employing the 'it will never happen' attitude, cannot be accepted either.

The OECD has identified and addressed such tax challenges caused by the digital economy through the Base Erosion and Profit Shifting project. The BEPS project starts with proposing solutions to tax challenges occurring due to the digital economy (Action 1). BEPS Action 1 dealing with tax challenges of the digital economy foresees to reduce the existence of gaps enabling a reduction of taxable income and the shifting of profits to favorable tax regimes by MNEs. The use of newly developing business models based on intangible assets, makes it practically impossible to establish a sufficient connection between business operations and jurisdictions. This presents an incentive for big players on the market to implement various tax avoidance practices.

BEPS Action 7 tries to mitigate these international tax problem areas. Within the digital economy, the PE status is often artificially avoided. MNEs implement such tax avoidance practices by various means, such as abusing the exceptions under Article 5 OECD MTC or by adopting doubtful commissionaire arrangements. Hence, BEPS Action 7 calls for a review of the definition and qualification of a permanent establishment to prevent the use of tax avoidance strategies to circumvent this status.

Moreover, the EU has acknowledged that it is vital for EU companies to take opportunities arising in the digital market to remain competitive. The Commission proposed concrete measures to ensure that taxes are paid where profits and value are created. The Anti-Tax Avoidance Package of the EU concedes that no international standard exists, but rather coexisting national interests and tax policies.

As the PE concept under the OECD MTC always supposes a certain degree of physical presence, even after the introduction of the Action Plan, the proposals will probably fail to solve the tax challenges arising from the digital economy. Remarkable steps have been taken by those countries implementing alternative measures, instead of applying the classical model of PEs. Four alternatives will be taken into consideration. (a) An equalization levy and (b) a new way of attributing profits do not convince as such, since concerns of international and EU law obligations are raised. (c) The same is true for the proposed withholding tax, which would otherwise be a very attractive and feasible option, especially in combination with a new nexus approach. (d) Notwithstanding, the possibility of a new nexus concept is not only viable in practice but also renders a real and actual solution to the problem of taxing the digital economy. The question arises whether the alternative proposals, which some countries have adopted in their jurisdiction, hinder the progress of the BEPS Action Plan rather than support it. It is without doubt that all these actions will further assist the countries in preventing tax evasion and in regulating the digital economy.

The paper will examine the case and investigations against Amazon in light of the proposals brought forward by the OECD. It will be determined whether these are in fact able to tackle and solve the problem, as occurred with Amazon Luxembourg. Lastly, it will be analyzed whether alternative solutions are available and useful.

9.4. Annex D – German abstract

Die Digitalisierung ist ein wachsendes Phänomen unserer modernen Wirtschaft. Traditionelle Unternehmen werden mehr und mehr durch digitale Unternehmen verdrängt. Das grenzüberschreitende Verschieben von Vermögen und die Fragmentierung von Tätigkeiten erlauben multinationalen Unternehmen das Vermeiden von Betriebsstätten und somit Besteuerung. Dies erfolgt durch Ausnutzung von Rechtssystemen und Steuerverträgen. Der Hauptbestandteil der Gewinne wird Rechtsprechungen mit vorteilhaften Steuerregimen zugeschrieben. Ein gebräuchliches Beispiel ist der Staat Luxemburg. Anfang der 2000er Jahre hat das Unternehmen Amazon mithilfe Luxemburgs seine Steuerstruktur radikal reformiert. Der größte Online-Einzelhändler hat durch das Verwenden eines komplizierten Patchworks von Tochtergesellschaften große Beträge seiner Gewinne verlagert (Project Goldcrest). Obwohl die zweifelhafte Geschäftsstruktur und Steuerpolitik Amazons an die Öffentlichkeit gelang und viel Kritik hervorrief, hat es dennoch das Gerichtsverfahren gegen die Steuerbehörde der USA gewonnen und entging auch weiteren steuerlichen Verpflichtungen in Großbritannien. Im Falle Goldcrest verdächtigt die Europäische Kommission den Luxemburger Staat, Amazon unfaire Steuervorteile gewährt zu haben. Damit unterliegt Amazon diesbezüglich Untersuchungen wegen staatlicher Beihilfe. Anhand solcher Praktiken der Steuervermeidung wird es schwierig, Optionen zur steuerlichen Bemessung der digitalen Wirtschaft zu finden. Bei einer zunehmenden Digitalisierung der Gesamtwirtschaft greifen speziell entwickelte Regeln nicht.

Die Organisation für wirtschaftliche Zusammenarbeit und Entwicklung (OECD) hat solche steuerlichen Herausforderungen in ihrem Projekt gegen die Aushöhlung der Bemessungsgrundlage und Gewinnverlagerung (BEPS) identifiziert und angesprochen. Das BEPS-Projekt schlägt Lösungen für die Probleme vor, die durch die digitale Wirtschaft entstehen (Handlung 1). Diese befasst sich mit den steuerlichen Herausforderungen und sieht vor, bestehende Schlupflöcher zu reduzieren. Diese ermöglichen den multinationalen digitalen Unternehmen eine Verringerung des zu versteuernden Einkommens und die Verlagerung von Gewinnen auf vorteilhafte Steuersysteme. Die Verwendung solcher neu entwickelter Geschäftsmodelle macht es nahezu unmöglich, eine ausreichende Verbindung zwischen Geschäftstätigkeit und Rechtsordnung herzustellen. Handlung 7 versucht solche internationalen Steuerprobleme zu minimieren. Sie fordert eine Modifikation der Definition von Betriebsstätten und eine Einschränkung von Ausnahmefällen. Das Ziel ist es den

Gebrauch von Steuervermeidungsstrategien und den Missbrauch von Ausnahmeregelungen zu verhindern. Das Konzept von Betriebsstätten im Rahmen des OECD-Musterabkommens beruht auf einer gewissen physischen Präsenz und erfasst keine Websites oder ähnliche Online-Strukturen. In der digitalen Wirtschaft wird dieser Status oft künstlich vermieden. Multinationale Unternehmen nutzen regelmäßig die Ausnahmeregelungen gemäß Artikel 5(4) des Musterabkommens, die sich auf vorbereitende und unterstützende Funktionen beschränken. Jedoch stellen gerade solche Aktivitäten zunehmend Kerngeschäftsfunktionen von Unternehmen dar. Durch die Beschränkung von Ausnahmen dieses Kriteriums und die Einführung einer Anti-Fragmentierungsregel will die OECD die Betriebsstätten-Vermeidung bekämpfen.

Die EU hat erkannt, dass es für europäische Unternehmen unerlässlich ist, die Möglichkeiten des digitalen Marktes zu nutzen, um wettbewerbsfähig zu bleiben. Konkrete Maßnahmen wurden durch die Europäische Kommission vorgeschlagen um sicherzustellen, dass Steuern dort gezahlt werden, wo Werte geschaffen und Gewinne erwirtschaftet werden. Gleichzeitig fungiert dieses Paket zur Vermeidung von Steuerumgehung als Durchführungsmaßnahme des BEPS-Projekts. Die wichtigsten Bestandteile stellen die Richtlinie zur Bekämpfung von Steuervermeidungspraktiken und die beiden Richtlinienvorschläge über gemeinsame Körperschaftssteuer-Bemessungsgrundlagen dar.

Bemerkenswerte Schritte wurden von den Ländern unternommen, die alternative Maßnahmen umgesetzt haben. Vier solcher Maßnahmen werden hier berücksichtigt: (a) Eine Ausgleichsabgabe und (b) eine neue Art der Gewinnzuweisung überzeugen als solche nicht, da Bedenken hinsichtlich völker-und EU-rechtlicher Verpflichtungen überwiegen. (c) Gleiches gilt für die vorgeschlagene Quellensteuer, die ansonsten sehr attraktiv und umsetzbar wäre, insbesondere in Kombination mit einem neuen Nexus-Ansatz. (d) Die Einführung eines neuen Nexus-Konzeptes ist nicht nur in der Praxis möglich, sondern stellt auch eine reale Lösung für das Problem der Besteuerung der digitalen Wirtschaft dar. Es stellt sich die Frage, ob diese alternativen Vorschläge den Fortschritt des BEPS-Aktionsplanes eher behindern als unterstützen.

Die Forschungsarbeit befasst sich mit den Vorschlägen der OECD, insbesondere mit der Frage, ob diese tatsächlich im Stande sind, die aufgeführten Probleme zu beheben. Zuletzt wird analysiert, ob Alternativlösungen verfügbar und nützlich sind. Die Forschungen basieren auf der Fallstudie Amazons.