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TITLE

TREATIES IN A BORDERLESS ECONOMY: AN ANALYSIS OF THE CHALLENGES RAISED BY E-COMMERCE

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Abstract

Technological advancements led sales and purchases activities to be performed via the internet giving rise to the formation of e-commerce. However, the international tax laws of cross-border e-commerce activities did not evolve at the same rate. This study is aimed at analyzing the challenges that e-commerce activities raise in the framework of the tax treaties entered into by States. The paper first analyzes the PE definition found in the tax treaties and determines their adequacy with respect to the reality of e-commerce applying OECD Commentaries. Then, it offers a re-evaluation of the PE threshold presenting three different approaches and discussing court cases that have had cascading consequences on the taxation of e-commerce. In the final chapter of the paper, the paper examines the challenges with respect to imposing taxes on e-commerce and reveals the opportunities for BEPS and treaty abuse that e-commerce activities may give rise to. The study ends with the conclusion that there are still actions that need to be taken to ensure that the challenges raised by e-commerce get solved and become expressed in the tax treaties that States sign.

Keywords: taxation of e-commerce, permanent establishment, tax treaties, BEPS, consumption tax, treaty abuse, OECD Commentaries.

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LIST OF ABBREVIATIONS

DTT	Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital
E-commerce	Electronic commerce
ISP	Internet Service Provider
OECD	Organization for Economic Co-operation and Development
OECD Model Treaty	OECD Model Tax Convention on Income and Capital
OECD Commentaries	Commentaries on the Articles of the Model Tax Convention (21.11.2017)
PE	Permanent Establishment
TFDE	Task Force on the Digital Economy, a subsidiary body established by the Committee on Fiscal Affairs of OECD
UN	United Nations
VAT	Value Added Tax
VCLT	Vienna Convention on the Law of Treaties

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E-commerce can and will be taxed –
the important thing is that it be taxed
fairly and efficiently.
Simon Woodside, Fiscal Affairs at OECD. Fiscal Affairs Division

INTRODUCTION

Bolstering innovation, improving business processes, and integrating economies are a few of the characteristics that resulted from a transformative process brought by information and communication technology.[1] For decades commerce has been viewed as an activity carried out in bricks and-mortar establishments visited by customers to make purchases. Yet, the development of technology has changed the manner in which business can be conducted. No longer are businesses confined to running activities in offices. The pervasiveness of information and communication technology led companies to use it for their own purposes and set a ground for the formation of e-commerce.

The term e-commerce has no widely accepted definition.[2] The definitions differ significantly depending on the various authors and sources. However, commonly e-commerce is known as the online sale or purchase of goods or services and the use of internet to make the payment.[3] E-commerce neglects the idea of distance and there are no national boundaries when carrying out activities via e-commerce. Hence, business can easily be conducted in foreign countries as a virtual establishment without owning premises or having customers visit their physical premises. This has resulted in a whole new paradigm shift in the way business is conducted.[4]

Therefore, fundamental questions rise related to the jurisdiction in which value creation and addition occur, how profits derived from non-resident entities should be taxed, and whether DTTs (or "tax treaties") entered into by states can play an effective role in the characterization of income for tax purposes.

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[1] "Tackling BEPS in the digital economy", in *Addressing the Tax Challenges of the Digital Economy*, OECD Publishing, Paris. (2014) https://doi.org/10.1787/9789264218789-9-en
[2] Martin Kutz. *Introduction to E-commerce. Combining business and Information technology*. Basics and Definitions (2016)
[3] *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*. OECD/G20 Base Erosion and Profit Shifting Project. Paragraph 217. Page 90. OECD Publishing, Paris. OECD (2015). http://dx.doi.org/10.1787/9789264241046-en
[4] Rifat Azam, *E-Commerce Taxation and Cyberspace Law: The integrative Adaptation Model*, Vol.12 No.5, Va. J.L. & Tech.1, 8 (2007)

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The growth in the tax treaty network has been phenomenal and there are over 3,000 tax treaties in force.[5] Tax treaties deal with the problem of overlapping tax jurisdictions by allocating taxing rights between the Contracting States to prevent double taxation. Conscious that taxes ought to be confined to taxable objects that have some sort of connection with the imposing State, according to the international tax law principle, States have a priority right to tax the income that has its source in that State.[6] This priority, however, is not easy to apply to cross-border e-commerce transactions, since the term "source" is not used or defined in tax treaties and States rely on the physical presence to impose taxes.

Consequently, while global e-commerce has grown tremendously and is expected to rise even more in the future, it blurs the traditional rules of international taxation.[7] Therefore, the legal framework in which e-commerce operates requires a fundamental reassessment. Hence, comes the subject of my thesis topic, “Treaties in a borderless economy: an analysis of the challenges raised by e-commerce.”

Literature related to the taxation of e-commerce can be divided into two strands of study: i) investigation of the tax challenges in the legal system that e-commerce raises; and, ii) assessment of the PE definition with respect to e-commerce.

In the first strand of literature, authors such as Cockfield, Forst, and Sweet separately study the national and international responses to tax challenges presented by cross-border e-commerce as well as examine tax legislation and analyze the issues related to the shrinking tax base that can jeopardize the economies.

In the second strand of literature, authors such as Akcaoglu address issues related to more specific issues in relation to e-commerce like PE, suggesting approaches that can help fairly allocate profits made by businesses in e-commerce.

Under these circumstances, this topic is of great interest for a few reasons. It is focused on a three-pronged discussion of a contemporary topic that is relevant from tax, legal and compliance viewpoints. It stresses the gap that tax treaties need to fill in by addressing the

[5] Michael Kobetsky. *International Taxation of Permanent Establishments: Principles and Policy*. Cambridge University Press. 2011

[6] Brian J. Arnold. *International Tax Primer*. Kluwer Law International B.V. 2016

[7] Subhajit Basu. *International taxation of e-commerce: persistent problems and possible developments*. Journal of Information, Law & Technology. (2008) https://warwick.ac.uk/fac/soc/law/elj/jilt/2008_1/basu/basu.pdf

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taxation of activities carried out via e-commerce; and, analyses a topic that plays a major economic role globally.

For that reason, this paper is structured as follows: in the first two chapters the views of the OECD are used to analyze in detail the PE definition found in the tax treaties and determine their adequacy regarding the concept and reality of e-commerce. This is further accompanied by the discussion of the proposals on PE assessment by Akcaoglu. Chapter 3 offers a re-evaluation of the PE threshold presenting three approaches and decisions of US courts that have had cascading consequences and offered re-evaluation of the taxation of e-commerce activities. In Chapter 4, the challenges when imposing taxes such as consumption tax (VAT) as well as BEPS and treaty abuse opportunities in e-commerce are considered. The final section summarizes the paper, which then ends up with the bibliography list.

CHAPTER 1 – THE ANALYSIS OF PE CONCEPT

International tax principles are defined as "the taxation of cross-border transactions" generally based on either resident taxation or source taxation.[8] Resident taxation provides a country the right to tax its resident on their worldwide income. Whereas, source taxation allows a country to tax income that originates in its jurisdiction.[9] There are competing views on whether residence taxation and source taxation have achieved the status of a customary law, but they may have achieved at least the status of being customary norms.[10] These two types of taxation sometimes cause jurisdictions to overlap and result in double taxation.[11]

1.1. Role of Tax Treaties

The harmful effects that double taxation poses are so well know that it is hardly necessary to highlight the importance that the international community has given to removing the obstacles that double taxation presents to the development of the economic relations between countries. [12] Desiring to apply uniform definitions, rules, and methods, as well as have a common interpretation of the financial situation of the taxpayers engaged in profit-seeking activities in

[8] *Supra note* 5
[9] *Supra note* 6
[10] *Supra note* 5
[11] *Supra note* 6
[12] *Model Tax Convention on Income and on Capital: Condensed Version 2017*. Page 9. Para. 1. OECD Publishing. OECD. (2017) https://doi.org/10.1787/mtc_cond-2017-en

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other countries, OECD member countries worked on forming common solutions to identical cases of double taxation.[13]

To deal with double taxation, countries started to conclude DTTs, which would prevent double taxation and allocate the taxing right between the contracting states.[14] Consequently, tax treaties have become the key legal mechanism for the coordination of states' jurisdiction to tax international business. They help reduce the negative impact of double taxation through the allocation of taxing rights to the State of residence (i.e. where the company has its base) and to the State of source (i.e. where the taxable operations takes place).[15] Being the keystone of the international tax treaty system, currently, most tax treaties are based on the OECD Model Treaty.[16] Even, the UN Model is relies on the OECD Model Treaty.[17]

The primary aim of OECD Model Treaty is "to clarify, standardize, and confirm the fiscal situation of taxpayers who are engaged in commercial, industrial, financial, or any other activities in other countries through the application of common solutions by all countries to identical cases of double taxation."[18] Notably, the impact of the OECD Model Treaty has extended far beyond the OECD area.[19] It has been used as a basic document of reference in negotiations even between non-member countries and plays an important role in international taxation while continuously developing rules and policies.[20]

1.2. Taxation of profits according to the Tax Treaties

Based on the OECD Model Treaty, the allocation of the rights to tax business profits of non-resident entities' operations depends on whether these operations constitute a "PE".[21] Article 7 of the OECD Model Treaty on the business profit provides that

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[13] *Ibid*
[14] *Supra note* 5
[15] Luis M. Almeida and Perrine Toledano. *Understanding how the various definitions of Permanent Establishment can limit the taxation ability of resource- rich source countries.* Columbia Center on Sustainable Investment. CCSI Briefing Note. (2018). http://ccsi.columbia.edu/files/2018/03/Optimizing-the-PE-clause-for-resource-riche-source-state-CCSI-2018-2.pdf
[16] *Supra note* 5
[17] *Ibid*
[18] *Model Tax Convention on Income and on Capital: Condensed Version 2008*. Page 7. Para. 2. OECD Publishing. OECD. (2008)
[19] *Supra note* 12. Page 12. Para. 14.
[20] *Ibid* 12. Page 12. Para. 14.
[21] *Supra note* 15

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"the profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a PE situated therein."[22]

This means that taxation is due at the source State if the non-resident entity carries on business in the other country and income is attributable to the PE.[23] Otherwise income is not taxable in a source country and the State of residence obtains the right to tax. The PE concept is thus used to determine whether or not a contracting state is entitled to exercise its taxing rights with respect to the e-commerce activities of a non-resident taxpayer. Accordingly, DTTs can result in source States losing significant tax revenue from the e-commerce operations of non-residents in their countries (unless such operations are conducted under a PE). Understanding the importance of PE, a separate article is commonly dedicated to defining a PE in tax treaties.

Part 1 of Article 5 of OECD Model Treaty defines the concept of a PE as

"a fixed place of business through which the business of an enterprise is wholly or partly carried on."[24]

Examples of PE are "a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources." The definition excludes some activities, including "the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise" and "the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise." [25]

Initially, the PE definition comprised of two distinct thresholds:

- a fixed place through which the business of the enterprise is wholly or partly carried on; or,

[22] *Supra note 12*. Article 7. Page 33.
[23] *Ibid*.
[24] *Ibid*. Article 5, part 1. Page 31.
[25] Ertugrul Akcaoglu. *International taxation of electronic commerce: A focus on the PE concept.* Ankara University Faculty of Law Journal. (2002).

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- a person acting on behalf of the foreign enterprise and habitually exercising an authority to conclude contracts in the name of the foreign enterprise in case no place of business can be found.

Both situations made it apparent that a geographical requirement such as a certain level of physical presence in the source jurisdiction was required before a PE could be triggered. This legacy is regularly emphasized in literature, [26] as well as reflected in the existing OECD Commentaries which states that the PE threshold "has a long history and reflects the international consensus that, as a general rule, until an enterprise of one State has a PE in another State, it should not properly be regarded as participating in the economic life of that other State to such an extent that the other State should have taxing rights on its profits."

Nonetheless, Hinnekens noted that there was nothing sacred about the legacy of the PE principle as a fixed place of business. Similarly, Doernberg observed that the PE concept simply denotes "a threshold that business activities in the source country must have reached in order to entitle a country to tax income. It is not unreasonable for this threshold to be adjusted for changes in the nature of business and in the way business is carried on".[27]

It is stated by Pinto that before examining how the concept of a PE can be redefined, it is important to question whether source-based taxation remains theoretically valid in today's globalized business world.[28] Therefore, the taxation of business profits under the PE threshold needs to be re-evaluated in light of e-commerce transactions.

1.3.Examination of PE definition

The current definition of PE in the OECD Model Treaty relies on the existence of either a physical or a representative presence (e.g. an agent) before source-based taxation can apply. Yet, the advent of e-commerce allows substantial business activities to take place in a source state without intermediaries making it more difficult to find a PE based on its traditional formulation under the OECD Model Treaty. Therefore the PE as defined in tax treaties no

[26] Arvid Aage Skaar. *Permanent Establishment: Erosion of a Tax Treaty Principle*. Kluwer Law and Taxation Publishers. (1991).
[27] Richard Doernberg, Luc Hinnekens, Walter Hellerstein & Jinyan Li, *Electronic Commerce and Multijurisdictional Taxation.* Kluwer Law International. (2001).
[28] Dale Pinto. *The Need to Reconceptualize the Permanent Establishment Threshold.* (2006) https://espace.curtin.edu.au/bitstream/handle/20.500.11937/38171/20960_downloaded_stream_416.pdf?sequence=2

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longer functions as an effective criterion to measure the nexus of the taxpayer with the source country.[29]

To consider the criteria triggering PE, reference should be made to OECD Commentaries. Yet, a question rises whether reliance can be placed upon OECD Commentaries when interpreting DTTs.

Interpretation is always conducted with a specific purpose—to establish the common intention of the treaty parties. Tax treaties are "international agreements concluded between states in written form and governed by international law".[30] As such, VCLT, which is a collation of customary international law in Article 31 provides support for the argument that the Commentary should be taken into account when interpreting treaties.[31]

While considering the definition of a PE, three conditions stand out whose presence is necessary for triggering a PE. Firstly, the enterprise must carry on a business, i.e. it must have a place of business. Secondly, there has to be a "fixed place of business," which would indicate a certain degree of permanency by the existence of a facility. And finally, the business must be carried out through such a fixed place.

1.3.1. Place of business

The U.S. Tax Court in *Consolidated Premium Iron Ores Ltd. v. CIR.*, 28 TC. 127 (1957) held that a Canadian company, which had only a mailing address in the United States but nothing else did not have a PE in the United States.[32]

The term "PE" normally implies the existence of an office staffed and capable of carrying on the day-to-day business of the corporation and its use for such purpose, or it suggests the existence of a plant or facilities equipped to carry on the ordinary routine of such business activity.[33]

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[29] *Supra note* 25
[30] *Vienna Convention on the Law of Treaties*, United Nations, Treaty Series, vol. 1155, p. 331, Article 2. (1969) https://www.refworld.org/docid/3ae6b3a10.html
[31] Ulf Linderfalk and Maria Hilling. *The Use of OECD Commentaries as Interpretative Aids - The Static/Ambulatory–Approaches Debate Considered from the Perspective of International Law.* DE Gruyter. (2015)
[32] *Consolidated Premium Iron Ores Ltd. v. Commissioner*, 28 T.C. 127 (T.C. 1957)
[33] *Ibid*

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Under Article 5(1) of OECD Model Treaty, it is clear that a place of business can consist of only tangible (physical) objects that are commercially suitable to serve as the basis for a business activity.[34] According to the Commentary on Article 5 concerning the definition of PE, the term "place of business" covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose. It is immaterial whether the premises, facilities, or installations belong to the enterprise. The place of business may be situated in the business facilities of another enterprise. [35] Therefore, the mere fact that an enterprise has a certain amount of space at its disposal which is used for business activities is sufficient to constitute a place of business.

Where the nature of the business activities carried on by an enterprise is such that these activities are often moved between neighboring locations, there may be difficulties in determining whether there is a single "place of business".[36] A single place of business will generally be considered to exist where a particular location within which the activities are moved may be identified as constituting a coherent whole commercially and geographically with respect to that business.[37] By contrast, where there is no commercial coherence, the fact that activities may be carried on within a limited geographic area should not result in that area being considered as a single place of business.[38] Clearly, a PE may only be considered to be situated in a Contracting State if the relevant place of business is situated in the territory of that State.[39] These conditions illustrate that a PE will only exist if the enterprise has a physical presence in the source state.

In traditional commerce, PE threshold can be applied with relative certainty, since business profits are attributed to the substantial presence of a corporation in a jurisdiction. E-commerce creates difficulties when it comes to the identification and location of taxpayers and it is also difficult to establish a link between the taxpayer and the transactions.[40] E-commerce usually does not require offices, factories or other physical locations in the country of the customers residence. None of the sites for carrying out the business as provided in the OECD Model Treaty are necessary or else present in e-commerce practice. Azam says that current source

[34] *Supra note* 25. Page 19 (2002).
[35] *Supra note* 12. Paragraph 1, point 10. Page 118.
[36] *Ibid*. Paragraph 1, point 22. Page 121.
[37] *Ibid.*
[38] *Ibid*. Paragraph 1, point 24. Page 121.
[39] *Ibid*. Paragraph 1, point 27. Page 122.
[40] *Supra note* 28.

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rule is based on the concept of "physical concepts of territory and place." However, this concept is weakened in e-commerce because a territorial border between countries is not important and location is hard to identify.[41]

1.3.2. Fixed place of business

According to the definition, the place of business has to be a "fixed" one. Thus in the normal way there has to be a link between the place of business and a specific geographical point, without a need for the equipment constituting the place of business to be actually fixed to the soil on which it stands. It is enough that the equipment remains on a particular site.[42]

Since the place of business must be fixed, it also follows that a PE can be deemed to exist only if the place of business has a certain degree of permanency, i.e. if it is not of a purely temporary nature.[43] A place of business may, however, constitute a PE even though it exists, in practice, only for a very short period of time because the nature of the business is such that it will only be carried on for that short period of time.[44] Yet, the practice of member states has shown that PE normally has not been considered to exist when the place of business was maintained for less than six months.[45]

From the above discussion it is apparent that a physical test is applicable in assessing a PE, whereas e-commerce can be conducted without having a physical presence in a country. Further, considering the interpretation given to paragraph 5 of Article 5 of the Model Tax Convention, even if an entity does not have a fixed place of business, but a dependent agent has the authority to conclude binding contracts in the name of the enterprise, the enterprise shall be deemed to have a PE. E-commerce activities do not usually require the involvement of a physical person to engage in signing such contracts.

1.3.3. The conduct of the business through such fixed place

The above two points imply that for a place of business to constitute a PE the enterprise using it must carry on its business wholly or partly through it.[46] In most cases, the business of an

[41] Rifat Azam, *E-Commerce Taxation and Cyberspace Law: The integrative Adaptation Model*, Vol.12 No.5, Va. J.L. & Tech.1, 8 (2007)
[42] *Supra note* 12. Paragraph 1, point 21. Page 121.
[43] *Supra note* 12. Paragraph 1, point 28. Page 122.
[44] *Ibid.*
[45] *Ibid.*
[46] *Supra note* 12. Paragraph 1, point 35. Page 124.

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enterprise is carried on by an entrepreneur or a person who is in a paid-employment relationship with the enterprise. These personnel include employees and other persons receiving instructions from the enterprise (e.g. dependent agents).[47]

The OECD Commentaries observes that a PE may also exist if the business of the enterprise is carried on mainly through automatic equipment, the activities of the personnel being restricted to setting up, operating, controlling, and maintaining such equipment.[48]

Under these circumstances, it is important to distinguish between activities that might have a preparatory or auxiliary character and those that might not. The decisive criterion in this case is whether or not the activity of the fixed place of business forms an essential and significant part of the activity of the enterprise as a whole.[49] A fixed place of business whose general purpose is identical to the general purpose of the whole enterprise does not exercise a preparatory or auxiliary activity.[50]

According to OECD BEPS Article 7 proposals, certain activities that were previously granted the benefit of these exceptions have become increasingly significant components of the digital economy and can no longer be entitled to an exception from PE status. For example, the maintenance of a very large local warehouse in which a significant number of employees work for purposes of storing and delivering goods sold online to customers by an online seller of physical products (whose business model relies on the proximity to customers and the need for quick delivery to clients) would constitute a PE for that seller.[51]

***** Three Tests proposed by Akcaoglu for PE assessment *****

Akcaoglu stresses three tests that can be used to analyze the PE concept.[52] These tests can be divided into three categories, which are "the objective conditions" of PE, "subjective conditions" of PE, and the "functional conditions" of PE. Some of these three tests are considerably important to e-commerce.[53]

"Objective conditions" of PE

[47] *Supra note* 12. Paragraph 1, point 39. Page 125.
[48] *Supra note* 12. Paragraph 1, point 41. Page 126.
[49] *Supra note* 12. Paragraph 1, point 59. Page 132.
[50] *Ibid.*
[51] *Supra note 3.*
[52] *Supra note* 25.
[53] *Ibid*. Page 134.

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The objection conditions of PE that Akcaoglu identified are not different from those described above. Likewise, for Akcaoglu, the starting point for PE is that there must be a "place of business" which must be fixed in terms of "the location" of the place of business.

Spain and Portugal oppose the view that the place of business in e-commerce requires a physical existence. According to these countries, enterprises conducting business in a country through a website can be treated as having a PE in that country with respect to the website.[54] Therefore, Spain and Portugal suggest that intangible or "digital" existence should be virtually enough to determine a place of business in relation to e-commerce, and the term "place" should be interpreted as including digital environments. Yet, the language of Article 5(1) of OECD Model Treaty is not that flexible enough to be interpreted as including digital presence.[55]

As for the "location test", the fact that a server is located in a particular place in the source country makes it pass the location test. Although, the server may move from one place to another in a source country, it still remains fixed as long as it stays in the source country and has a determinable location.[56]

"Subjective conditions" of PE

A fixed place of business in a country is not sufficient alone, two subjective tests: the "right of use test" and the "permanence test" must also be satisfied.

The requirement of OECD Commentaries to have a fixed place of business at its "disposal" implies the ability of the enterprise to control the use of its place of business in a given country.[57]

- Right of use test

It is common for enterprises to carry on business through websites hosted on the servers of ISPs. Such a hosting agreement typically does not give a non-resident enterprise the

[54] *Clarification on the application of the PE definition in e-commerce: Changes to the commentary on the Model Tax Convention on Article 5.* OECD Committee on Fiscal Affairs. Paragraph 6 (2000).
[55] *Supra note* 25. Page 139.
[56] *Supra note* 25. Page 140
[57] *Ibid*.

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ability to control a server's location and its activities, although the agreement might let the enterprise determine the server on which to host the website and its location. Yet, on a case-by-case analysis a hosting agreement might cause a server to be at the disposal of a non-resident enterprise.[58] As an example, when a non-resident enterprise owns a server through which the business is performed and operates it, then the server is at the enterprise's disposal, and could constitute a PE, if the remaining tests are also met.

- Permanence test

The definition of OECD Model Treaty suggests that the activities of the nonresident enterprise should have a degree of permanence sufficient to be a regular economic presence in the source country. [59] According to Akcaoglu, permanence does not mean that the place of business must be everlasting; but it means to use that place for the time being. Therefore, certain duration is required. As an example, the organization of a tradeshow in a source country does not cover a sufficient time-period to trigger a PE. In any case, since servers can be moved from one place to another, the application of permanence test to servers needs to be examined on a case-by-case basis.

"Functional conditions" of PE

Akcaoglu considers the functional conditions of PE under the Business activity test and Business connection test.

- Business activity test

OECD Model Treaty does not contain an exhaustive definition of the term "business", but according to Article 3(2) of the Model treaty any activity that is considered a business under domestic law will fall under the business concept from the perspective of the tax treaty. Therefore, a server may constitute a PE if the income generating activities conducted through that server fit in the definition of business activities under the domestic law of the source country.[60]

[58] *Supra note* 54. Paragraph 42.5.
[59] *Supra note* 12. Paragraph 1, point 28. Page 122.
[60] *Supra note* 25. Page 142.

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On the one hand, if the domestic law of the source country has a limited scope and it does not cover the activity performed by the server, then the server will not be considered a PE. On the other, even if the activities performed by the server fall under the concept of business, but are of preparatory and auxiliary nature, then the server may still be excluded from the PE definition under the treaty provisions.[61] For example, if the server is only used for storage or display purpose, it cannot be determined that the enterprise has a PE in a source country. Additionally, non-resident enterprise does not have a PE in a country if it uses its server solely for the purpose of storage, display or delivery of goods or else "providing a communications link much like a telephone line between suppliers and buyers, advertising of goods and services".[62]

- Business connection test

OECD Model Treaty also requires that the business activity of the enterprise be connected to the place of business: the activity must be performed 'through' the place of business. It does not need to be performed without interruption, but must be carried out on a regular basis.[63] In case of e-commerce, activities must be performed through a server.[64]

CHAPTER 2 – ANALYSIS OF E-COMMERCE FROM THE PERSPECTIVE OF PE

2.1. Computer equipment

Much discussion has taken place on whether the mere use of computer equipment for e-commerce operations in a country could constitute a PE. This question raises a number of issues in relation to the provisions of Article 5 in DTTs.[65] OECD Commentaries give a clarification on how the definition of PE should be applied to e-commerce operations.

It seems logical that as a physical and tangible object an automated equipment that is situated in a country will constitute a PE. However, it is important to distinguish between computer equipment and the software or data which is used by or stored on that equipment. [66]

[61] *Ibid*. Page 142.
[62] *Ibid*. Page 143.
[63] *Supra note* 12. Paragraph 1, point 35. Page 124.
[64] *Supra note* 25. Page 144 .
[65] *Supra note* 12. Electronic commerce. Paragraph 122. Page 151.
[66] *Ibid*. Paragraph 123. Page 152.

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It is clear that computer equipment will trigger a PE, where an enterprise operates computer equipment at a particular location even though no personnel of that enterprise is required at that location for the operation of the equipment.[67]

In terms of software or data constituting a web site, there is no location, premise, machinery or equipment that can lead to a "place of business."[68] Websites are digital documents that internet users access to purchase goods or services.[69] Yet, the server on which the website is stored and accessible is a piece of equipment having a physical location and such location may thus constitute a "fixed place of business" of the enterprise that operates that server.[70] It is common for the website through which an enterprise carries on its business to be hosted on the server of an ISP.

Nonetheless, that enterprise cannot be regarded as having a PE because the website is intangible, lacking physical presence and control. Furthermore, it also states that to constitute a PE, the presence of personnel are not necessary if the nature of the business does not require personnel to operate.[71] The ISP cannot be regarded as a dependent agent of an enterprise under Article 5 since it does not have an authority to conclude a contract on behalf of the enterprise.[72] In fact, the server hosts and provides ISP for many services, so that it is impossible to conclude contracts on behalf of the other enterprise therefore the ISP cannot be regarded as an agent PE. [73] However, if the other requirements as stipulated in the DTT are met, PE will be triggered only if the enterprise has a server at its own disposal and carries on business through a website which is stored on the server.[74]

2.2. Human interaction

As a matter of fact, OECD Commentaries may provide that a server cannot be a PE in the absence of human intervention.[75]

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[67] *Ibid*. Paragraph 125. Page 152.
[68] Preventing the Artificial Avoidance of PE Status, Action 7 – 2015 Final report. OECD/G20 Base Erosion and Profit Sharing Project. OECD Publishing, Paris. https://read.oecd-ilibrary.org/taxation/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report_9789264241220-en#page1
[69] *Supra note* 25. Page 138.
[70] *Supra note 12*. Electronic commerce. Paragraph 123. Page 152.
[71] *Ibid* 12. Paragraph 127. Page 153.
[72] *Ibid* 12. Paragraph 131. Page 154.
[73] *Ibid.*
[74] *Ibid*. Paragraph 124. Page 152.
[75] David L. Forst. *Old and New Issues in the Taxation of Electronic Commerce.* Berkeley Technology Law Journal. (1999). https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1244&context=btlj

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However, in what came to be known as the "German Pipeline" case, German Tax Court ruled that a Dutch corporation that owned automatic equipment (pipe lines) in Germany constituted a PE, despite the presence of personnel there.[76]

Being a resident of the Netherlands, the corporation transported crude oil products for other enterprises through its own pipeline situated between the Netherlands and Germany. The process was remotely controlled by the computers and the pipeline ended in Germany. There were no employees in Germany and independent contractors provided maintenance and repair services for the pipelines in Germany. In its holding, the court ruled that in case of fully automated equipment, there can be a PE without the existence of human presence. Particularly, "it is sufficient that a pipeline is used only to enable the transport of oil from one point to another for it to constitute a PE."[77]

2.3. E-commerce (General PE comments)

Probably, in the past, for an enterprise having equipment in a country was useless without having necessary personnel to operate it because machines were not capable to generate income alone. Therefore, it was not appropriate to accept source country's taxation right merely based on the view that the machinery or equipment was located in that country.[78]

It has been observed that finding the existence of a PE may easily be avoided by moving operations to a server in another country before the conditions of being "fixed" under the PE test are satisfied.[79]

In any case, no PE may be considered to exist where the e-commerce operations carried on through computer equipment at a given location in a country are restricted to the preparatory or auxiliary activities. This question needs to be examined on a case-by-case basis having regard to the various functions performed by the enterprise through that equipment. Examples of activities which would generally be regarded as preparatory or auxiliary include:

[76] John K. Sweet. Formulating international tax laws in the age of electronic commerce: The possible ascendancy of residence-based taxation in an era of eroding traditional income tax principles. 146 U. PA. L. REV. 1949 (1998) https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=3467&context=penn_law_review

[77] Knut Olsen. *Characterization and Taxation of Cross-border Pipelines*. IBFD. (2012)

[78] *Supra note* 25. Page 138 .

[79] *Supra note* 26.

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provision of a communications link, advertising of goods or services; gathering market data for the enterprise; supplying information.[80]

Where, however, such functions form in themselves an essential and significant part of the business activity of the enterprise as a whole, or where other core functions of the enterprise are carried on through the computer equipment, these would go beyond preparatory and auxiliary activities and if the equipment constituted a fixed place of business of the enterprise, there would be a PE.[81]

What constitutes core functions for a particular enterprise clearly depends on the nature of the business carried on by that enterprise. For instance, some ISPs are in the business of operating their own servers for the purpose of hosting web sites or other applications for other enterprises. For these ISPs, the operation of their servers in order to provide services to customers is an essential part of their commercial activity and cannot be considered preparatory or auxiliary.[82]

From the above it seems that a PE based on DTTs will only be deemed to exist if an entity carries on business through a website that has a server at its own disposal, at a fixed location, and the business of the entity is not of a preparatory or auxiliary nature.

CHAPTER 3 – RE-EVALUATION OF THE PE THRESHOLD

Three approaches are discussed below that suggest re-evaluating the PE approach. These are the base-erosion approach, the virtual PE approach, and the refundable withholding approach. The chapter then presents the landmark decisions of the US courts in terms of the taxation of the e-commerce activities concluding by the unanticipated decision in *South Dakota v. Wayfair*, which can set a ground for the re-evaluation of the PE threshold currently found in tax treaties.

3.1. Three approaches

3.1.1. The base-erosion approach

[80] *Supra note* 12. Electronic commerce. Paragraph 128. Page 153.
[81] *Ibid*. Paragraph 129. Page 153.
[82] *Ibid*. Paragraph 130. Page 153.

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Base-erosion approach is set to operate within the existing international tax regime. The goals of the base-erosion approach are to address two main concerns. First, countries where enterprises are highly engaged in e-commerce transactions are concerned that they may leave the existing and any new tax base generated by e-commerce untaxed.[83] Second, the application of inconsistent tax principles gets countries concerned about the likelihood of double taxation caused by e-commerce.[84]

Base-erosion approach suggests imposing withholding taxes at a single rate on any payment that might erode a country's tax base. A payment is considered to erode the source country's potential tax base, when it constitutes an expense that is either deductible or is part of the purchaser's cost of goods sold (which is again deducted from revenue to get the gross income). If any of these conditions apply, irrespective of the category of the income withholding would be used under the base-erosion approach.[85]

This feature is intended to solve problems related to the characterization, because withholding can be applied independently from the characterization of the income in the transaction.[86]

Besides, within the scope of the base-erosion approach the withholding tax is intended to be credited in the residence country. The idea is that base-erosion approach is premised on allocating taxable income between source and residence countries, instead of increasing the overall level of taxation. This feature is not only designed to allocate tax base between residence and source countries, but to also act as a mechanism to avoid double taxation.[87]

A final feature of the base-erosion approach is the inclusion of a mechanism to allow sellers, i.e. the recipient of income, to file taxes on a net basis in source countries. The idea is to overcome grossing up the income received with potentially excessive taxes and to avoid possibilities of double taxation. [88]

This approach allows source countries to benefit by withholding taxes from any base-eroding payments that their residents make to the counter-parties in residence countries. A relief is also granted by providing credits to prevent double taxation. Nevertheless, problems with this

[83] Richard Doernberg & Luc Hinnekens. *Electronic Commerce and International Taxation*. (1999).
[84] *Ibid*
[85] *Ibid*
[86] *Ibid*
[87] *Ibid*
[88] *Ibid*

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approach are also evident, since there is a risk that excessive tax-credits might be applied, which need to be effectively overcome to ensure that the approach can operate in a way that is acceptable to most countries.[89]

3.1.2. The virtual PE approach

Advocated by Hinnekens, the virtual PE approach aims firstly at lowering the PE threshold by removing from the definition the requirement for a "fixed place of business" in the source country. This means that the tax nexus will be established PE by allowing the source country to entertain tax jurisdiction on the basis of a virtual PE.[90] Secondly, Hinnekens argued that the traditional PE concept can be redesigned to accommodate e-commerce transactions in a way that taxes these transactions consistent with the principles of economic allegiance and equivalence. Such an approach will help achieve a sharing of revenues between e-commerce exporting and importing countries by finding a compromise between their interests.

Though radical at first sight, Skaar further suggested abandoning the present PE concept as the leading condition for tax jurisdiction and introduce a system of source-state taxation of business profits.[91] Meanwhile, Skaar noted that developed countries as a group will hardly accept this idea and considered leaving the re-invention of PE concept to the development of case law and bilateral tax treaty practices. For this reason, Skaar suggested that source countries "seek to include PE fictions in their treaties for industries where the lack of physical location is predominant." This thinking supports Hinnekens' proposal on the virtual PE approach, which is targeted at creating a fiction in determining the tax nexus of a source-country.[92]

Nevertheless, the problem with this approach is that it can be difficult to establish an internationally acceptable standard for determining when a virtual PE should exist which will affect the successful implementation of this approach. These problems are made even worse when the attribution of business profits to the virtual PE is considered.[93]

3.1.3 Refundable withholding approach

[89] *Ibid*
[90] *Supra note* 28.
[91] *Supra note* 26.
[92] *Ibid*.
[93] *Supra note* 28.

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To establish the source-country tax nexus, the refundable withholding approach proposes an alternative to the PE threshold but draws upon the elements from the above proposals. It suggests withholding at a uniform rate from all international e-commerce transactions.[94] Doernberg's base-erosion withholding approach represents a leading example for such approach.[95] Countries such as India already seek to rely on withholding approaches when taxing e-commerce transactions.

This approach does not require a revision of tax treaties, because they can unilaterally apply and enact them. The system is also designed to avoid the difficult issues regarding the classification of income that could become more problematic in the e-commerce context.[96]

However, concerns regarding the refundable withholding approach relate to the fact that the system resembles a consumption tax and not an income tax, since income is taxed there where the consumption takes place. Therefore, it seems more reasonable for taxation to occur in those countries where consumption happens similar to allocating an origin-based VAT to the production country.[97]

3.2. E-commerce in US courts

Within the framework of tax treaties, no court cases have been found to address the taxation of cross-border e-commerce activities. However, the practice of US courts has started to get rich with landmark judgments of relevance to the activities conducted via e-commerce that cover notions stipulated in the tax treaties.

3.2.1 National Bellas Hess, Inc. v. Department of Revenue[98]

As a mail order house with its principal place of business in Missouri, National Bellas Hess, Inc. owned no property, sales outlets or employees in Illinois. National Bellas Hess simply used the postal system or a common carrier to mail catalogues twice a year to customers throughout the United States, including Illinois. Pursuant to the judgment received from the Illinois Supreme Court, National Bellas Hess had established a minimal connection with

[94] *Ibid*.
[95] *Supra note* 83.
[96] *Supra note* 28.
[97] *Ibid*.
[98] *National Bellas Hess, Inc. v. Department of Revenue of Ill*., 386 U.S. 753 (1967). https://supreme.justia.com/cases/federal/us/386/753/

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Illinois, and should have therefore been subject to the law that required the collection of Illinois' tax.

The Court ruled that the collection of tax could be done only if National has a "physical presence" in Illinois and a presence established solely by common carrier or through US mail or common carrier was insufficient. "State taxation falling on interstate commerce . . . can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys" *Freeman v. Hewit,* 329 U. S. 249, 329 U. S. 253. The Court added that US Constitution requires "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." Therefore, the Court decided that only mail order activity was not sufficient to collect the tax unless there was some physical presence in the state.

Though this case is not directly linked to the activities that are carried out via e-commerce, it does stress the fact that over a dispute on taxation of an entity that had no physical presence, US Supreme Court also held that the state does not have an authority and right to tax when there is no presence found. This ruling confirms the reasoning found at present in OECD Commentaries regarding the taxation of e-commerce businesses.

3.2.2 Quill Corp. v. North Dakota

As given in the Supreme Court's holding above, US taxes transactions that take place within the confines of a State. In numerous cases the Court ruled that a physical presence or nexus is necessary in order for the taxation to be valid.[99] In 1992, the Supreme Court heard a case of Quill Corporation v. North Dakota,[100] which prevented states from collecting any sales tax from retail purchases made over the internet or other e-commerce route unless the seller had a physical presence in the state.

Being from Delaware, Quill Corporation sold office equipment and stationery in North Dakota, by using catalogs, flyers, advertisements in national periodicals, and telephone calls. Quill Corp neither had office or else employees working or living in North Dakota.

[99] *Supra note* 27.
[100] *Quill Corp. vs. North Dakota*, 504 U.S. 298 (1992). https://supreme.justia.com/cases/federal/us/504/298/case.pdf

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North Dakota imposed a use tax on property purchased for storage, use, or consumption in the state due to the solicitations made in the State. However, Quill denied to pay the tax and appealed to a higher court and the ruling was favored to the Quill with the reasoning that Quill had no physical presence or lacked nexus with the State, so that the sales tax should not be collected.

What is strikingly important the North Dakota Supreme Court considered Bellas Hess as obsolete, based on the changes in society and the mail-order industry since 1967. Therefore, the Court distinguished two tests of a "nexus" based on U.S. Constitution's Due Process and Commerce Clause. The Court used these two tests to determine whether there was sufficient connection with North Dakota for taxation.

The Court noted that the remote seller becomes subject to taxation when they "purposefully direct" their efforts toward a state to solicit the business. Therefore, under the circumstances of this case, Quill Comp had "purposefully availed" itself to conduct business in the state with an intention to profit there and the tax was fairly imposed. [101] On the other hand, the Court explicitly stated that "a [out-of-state seller] whose only contact with the taxing State is by mail or common carrier lacks the "substantial nexus" required by the Commerce clause." Since Quill did not have the requisite physical presence, North Dakota's tax was unconstitutional as a restriction on interstate commerce.

This case is important in that the Court gave the holding at a time when e-commerce was yet to rise. It is worth noting that the Court did not only stick to the idea of the physical presence but also introduced the concept of the commerce class to determine the state's right to tax the activities carried out via e-commerce. Nevertheless, the absence of a clear definition of what qualifies as a physical presence makes it difficult to apply the physical presence standard in an e-commerce setting.

3.2.3 South Dakota v. Wayfair

In mid-2018, US Supreme Court decided the historic Wayfair case which has had cascading consequences for the e-commerce industry. Like in many US states, retail sales of goods and

[101] *Ibid.*

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services are taxed in South Dakota and there is a requirement on sellers to collect and remit taxes to the State.[102]

Wayfair had no employees or real estate in South Dakota. Concerned about the erosion of its sales tax base and corresponding loss of critical funding for state and local services, South Dakota legislature enacted a law requiring out-of-state sellers to collect and remit sales tax "as if the seller had a physical presence in the State" and set a minimum sales threshold for that. Wayfair met the minimum sales requirements set by the legislature, but did not collect the State's sales tax. Consequently, to ensure that the Act's requirements are valid and applicable to Wayfair, South Dakota filed suit in state court. Yet, Wayfair argued for the Act's unconstitutional nature. Motion was granted and Quill was identified as the controlling precedent.

In its holding the Court noted that modern e-commerce did not align analytically with a test that relied on the sort of physical presence defined in Quill and its physical presence rule was artificial not just "at its edges," but in its entirety. The Court stated that the physical presence rule as defined by Quill was no longer a clear or easily applicable standard and therefore overruled the physical presence rule of Quill. Consequently, regardless of the absence of the physical presence, Wayfair was subjected to paying taxes in South Dakota.

This decision will affect everyone engaged in e-commerce activities in US. Not only does this holding extend the state's authority to tax enterprises that lack a physical presence, but it has brought forward a re-evaluation of the PE approach that at present is not provided by the tax treaties or else suggested by OECD Commentaries.

CHAPTER 4 – CHALLENGES WHEN IMPOSING TAXES ON E-COMMERCE

4.1 Addressing Base Erosion and Profit Shifting

In the current framework of conducting cross-border business, it is often the case that an affiliate might be established in a low-tax environment to lend to entities operating in high tax jurisdictions. Such engagements can present BEPS concerns in countries where business operations actually take place. [103] These situations undermine the integrity of the tax system

[102] *South Dakota v. Wayfair, Inc., et al.* 585 U. S. __ (2018) https://www.supremecourt.gov/opinions/17pdf/17-494_j4el.pdf
[103] *Supra note* 3. Paragraph 220. Page 91.

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and potentially increase the difficulty of reaching revenue goals, whereas, tax treaties fail to address such issues. As such, to develop a report identifying issues raised by the digital economy and to address them, TFDE concluded that "neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility" should apply to e-commerce.[104] In that regard, several BEPS minimum standards can be identified concerning the digital economy.

Nexus and the presence without taxation[105]

The fact that it has become possible to generate a large quantity of sales without a taxable presence causes not to overstate the issue of nexus. [106] As mentioned under Chapter 1, tax treaties do not permit the taxation of a non-resident's business profits in the absence of a PE to which profits are attributable.[107] The issue of nexus goes beyond questions of PE under tax treaties. Even though the absence of limitations by tax treaties leads to BEPS, it appears that many jurisdictions would not consider this nexus to exist under their domestic laws. As 2014 Deliverable of BEPS project Action 1 states many jurisdictions would not tax income derived by a non-resident enterprise from remote sales to customers located in that jurisdiction unless the enterprise maintained some degree of physical presence in that jurisdiction. As a result, the issue of nexus also relates to the domestic rules for the taxation of non-resident enterprises.[108]

Characterization of income derived from new business models

Along with forming different business models, digital technology has also raised questions on how to characterize certain transactions and payments for tax treaty law purposes.[109] Despite the work of the Treaty Characterization Technical Advisory Group, the character of the payments made in the cloud computing is not specifically addressed in the existing Commentary to the OECD Model Treaty. A frequent question asked for tax treaty purposes is whether such payments should be treated as royalties (particularly under treaties in which the definition of royalties includes payments for rentals of commercial, industrial, or scientific

[104] *Addressing the Tax Challenges of the Digital Economy*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing. OECD. (2014). https://www.oecd-ilibrary.org/docserver/9789264218789-en.pdf?expires=1555175602&id=id&accname=guest&checksum=FF9BAD465CA382AC9DD6EAA11B237DD7
[105] *Ibid*. Page 127.
[106] *Ibid*
[107] *Ibid.* Page 129.
[108] *Ibid.*
[109] *Ibid*. Page 133.

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equipment), fees for technical services (under treaties that contain specific provisions in that respect), or business profits.[110]

If under most tax treaties business profits are taxable in a country when they are attributable to a PE located therein; royalties, may be subject to withholding tax in the country of the payer, depending on the terms of any applicable treaty.[111] Consequently, depending on whether a transaction is characterized as a business profit or another type of income, different treatments can be applied for tax treaty purposes to eliminate opportunities for BEPS.

4.2. Application of consumption tax in the tax treaty framework

It is well known that the VAT mechanism works well when the supplier, who is a registered VAT payer and the recipient are residents of the same country. However, e-commerce puts a question on the applicable of the current international tax rules to determine where economic activities are carried out and value for tax purposes is created leading to an analysis of the challenges present in VAT systems.[112]

Domestic laws and tax treaties treat different types of income generated by cross-border activities differently.[113] Each country can impose their own VAT rules, which can sometimes lead to double taxation. This is why multinational enterprises can minimize the tax burden and obtain a competitive advantage by exploiting the arbitrage between the VAT systems of the countries.[114] Further, no records of the invoice might be created because customer orders are placed and completed electronically and therefore the only record that exists from these transactions could be an encrypted electronic one, which might not reveal information about the value of a transaction. [115] Unless appropriate controls are set, electronic records can be altered without leaving evidence of the destruction or alteration.[116] Accordingly, the validity of information for e-commerce transaction may create challenges in terms of enforcing the

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[110] *Ibid.* Page 132.
[111] *Ibid*. Page 133.
[112] *Ibid*. Page 126.
[113] Arthur J. Cockfield. *The rise of the OECD as informal "world tax organization" through national responses to e-commerce tax challenges.* Yale Journal of Law and Technology. (2006). https://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1026&context=yjolt
[114] Gerhard Badenhorst. *The VAT challenges of cross-border supplies*. Tax Talk. (2013) https://www.thesait.org.za/news/146080/The-VAT-Challenges-Of-Cross-Border-Supplies.htm
[115] Riana du Plessis. *Cyberlaw@SA III: the law of the Internet in South Africa.* Van Schaik Publishers. (2006)
[116] Eric E. Cohen. *The Need for and Issues Surrounding the Seamless Audit Trail.* (no date). https://www.oasis-open.org/committees/download.php/16709/Tax%20XML%20AuditTrail_60215

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relevant tax legislation and verifying the location or parties involved.[117] For example, a seller of electronic information may claim to be a resident of a treaty country and thereby entitled to a reduced or zero rate of withholding tax on royalties. [118] The determination of location is of crucial importance, since it allows to determine whether the transaction is subject to taxation or not and if so which state can apply its VAT principle to the transaction.[119] Therefore, it is questionable whether the parties to a tax treaty can find any relevant ground for taxing the transactions. [120]

As a recommendation, the Committee for Fiscal Affairs of OECD suggested that tax authorities consider requiring that businesses engaged in e-commerce transactions identify themselves to revenue authorities in a manner that is comparable to the prevailing requirements for businesses engaged in conventional commerce in a country.[121] Nonetheless, the growing ease with which websites can be located offshore as can be seen has certainly limited the success this initiative could have. For this reason, verifying the identities of parties to a business transaction may be difficult in the world of e-commerce.[122] Consequently, structures that shift profits to locations that do not tax or tax at more favorable rates cause treaty abuse and generate BEPS concerns.[123]

4.3. Prevention of treaty shopping

Action 6 of OECD Action Plan on Base Erosion and Profit Shifting provides,

> *"Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country."* [124]

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[117] Dale Pinto. *Taxation Issues In A World Of Electronic Commerce.* Journal of Australian Taxation (1999) http://www.austlii.edu.au/au/journals/JlATax/1999/19.html
[118] *Supra note* 115.
[119] Bert Laman. *European value added tax (VAT).* Praxity – Global Alliance of Independent Firms. (2013) https://www.bkd.com/sites/default/files/2018-10/european-value-added-tax.pdf
[120] Richard Jones & Subhajit Basu. *Taxation of Electronic Commerce: A Developing Problem.* International Review of Law Computers & Technology. (2002). http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.101.2737&rep=rep1&type=pdf
[121] *Supra note* 117.
[122] *Ibid*.
[123] Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Page 15. OECD (2015) https://www.oecd-ilibrary.org/docserver/9789264241695-en.pdf?expires=1557172420&id=id&accname=guest&checksum=DE273B595D885CFB3E3A5D9862604833
[124] *Ibid*.

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The aim of including this action is to address those treaty shopping arrangements in e-commerce that promote the set-up of companies in a country to take advantage of its treaty network rather than do business.

To determine the best way to prevent the granting of treaty benefits in inappropriate circumstances, a distinction must be made between cases where a person tries to circumvent limitations provided by the treaty itself and cases where a person tries to circumvent the provisions of domestic tax law using treaty benefits.

Cases where a person tries to circumvent limitations provided by the treaty itself

Tax treaty benefits become applicable when the entity is "a resident of a Contracting State", as defined in Article 4 of the OECD Model Treaty. However, there are a number of attempts that might be made by a non-resident to obtain the benefits granted to the residents of that State.

To solve this issue, at a minimum, contracting states should agree on adding an express statement in the tax treaties that the intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements. [125] The way in which this minimum standard will be implemented in each bilateral treaty depends on the agreement between the Contracting States, but it applies to existing and future treaties.

Cases where a person tries to abuse the provisions of domestic tax law using treaty benefits

Risks that threaten the tax base may not be caused by tax treaties but be facilitated by the treaties. Merely addressing such treaty issues is not sufficient, changes to domestic law are also required. Taxes can be artificially avoided by fragmenting operations among multiple entities in order to qualify for the exceptions to PE status for preparatory and auxiliary activities, or by otherwise ensuring that each location through which business is conducted falls below the PE threshold.[126]

[125] *Supra note* 123.
[126] *Ibid*.

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The main challenge when solving this issue is to ensure that no conflict rises between domestic anti-abuse rules and those granted by the treaty. Since when income remains without being taxed BEPS concerns are raised.[127]

CONCLUSION

Digital technologies make it easier to do business across jurisdictions, as well as enable consumers to access products and services from anywhere in the world. This is why, this paper focused on the international taxation of e-commerce activities and the challenges that it raises within the framework of the tax treaties that States have entered into. The paper first reviewed the PE concept discussing the criteria that according to the definition given by the OECD Model Treaty trigger PE. Under current treaty rules, the taxing right on non-resident business income is all dependent on the concept of "PE" and "attribution rule." However, it was found that PE concept defined by OECD could not be easily applied to e-commerce transactions due to their borderless character. To tax, a requirement of having a fixed place of business through which an enterprise does e-commerce in the contracting state is imposed. Accordingly, three tests proposed by Akcaoglu were discussed as alternatives for the interpretation and application of OECD Model Treaty to help clarify the scenarios which might lead to the taxation of businesses engaged in e-commerce.

This analysis was followed by the application of OECD Commentary on e-commerce activities. It helped determine that the presence of a server or automated equipment under the disposal of an entity in a specific location irrespective of human interaction could be sufficient to tax activities carried out via e-commerce in a State.

To ensure the contemporary nature of the acting PE threshold, a re-evaluation of the criteria leading to the taxation of e-commerce activities was proposed. Three approaches were presented each of which as evidenced could potentially be used as substitutes for the taxation of e-commerce activities in addition to applying the PE threshold. This pool of alternatives was substantiated by the briefing of three US Supreme Court cases, of which *South Dakota v. Wayfair* introduced a new approach for the taxation of e-commerce transactions. In contrast to the provisions found in the tax treaties, pursuant to this Courts holding, e-commerce activities

[127] *Ibid*.

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can be taxed in a specific state even without a physical presence there in case their sales exceeded a certain level of sales threshold that South Dakota set.

The last chapter examined the challenges with respect to imposing taxes on e-commerce. The difficulties in finding a nexus and characterization of income widened the gap tax treaties had in terms of covering issues related to cross-border e-commerce activities. This was further stressed by the challenge related to the imposition of a consumption tax that happened to trigger opportunities for BEPS and treaty abuse.

Consequently, as this analysis showed there are still actions that need to be taken by the international legal community to address the challenges raises by e-commerce. The findings of this study showed the relevance of incorporating provisions in tax treaties to ensure that taxation of e-commerce activities gets covered too. For future studies, it would be interesting to consider incorporating the changes that States make in the domestic legislation to mitigate the difficulties that e-commerce brings with respect to taxation. For now it is clear that e-commerce raises many challenges in the framework of international tax law. Thus, the need to address the taxation of cross-border e-commerce activities certainly remains high when considering the treaties states have signed in this borderless economy.

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