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**International Taxation of Digital Economies:
Impact of Digital Business Models on
Existing Conventional International
Taxation Approaches**

Julian Bach

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Editors: Siegfried Fina, Mark Lemley, and Roland Vogl

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Stanford Law School
Crown Quadrangle
559 Nathan Abbott Way
Stanford, CA 94305-8610

University of Vienna School of Law
Department of Business Law
Schottenbastei 10-16
1010 Vienna, Austria

About the Author

Julian Bach graduated with an LL.M. degree in European and International Business Law from the University of Vienna School of Law, Austria, in 2020. He holds an LL.B. degree in Good Governance from the University of Rostock, Germany, and the admission for the German bar exam in law from the Johannes Gutenberg University of Mainz, Germany. He was President of the European Law Student's Association in Mainz, and founded two small companies parallel to his studies in Rostock. Julian Bach lives with his wife and daughter in Hamburg, Germany, and works for an investment management firm.

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Abstract

Digitalization is everywhere: it changed our communication and it changed our businesses and it basically changed our ability of applying theories to practically relevant challenges. Many benefits of our 21st century welfare are strongly connected to digitalization. But there are also new legal challenges arising out of the nearly limitless use of digital possibilities in our lives. Purchases are made on virtual marketplaces; advertisement gets individually targeted and geographic movement gets tracked online. All this is based on data, more detailed based on data collection, data processing and data analytics. The potential for data-driven businesses to gain serious turnovers and profits is high. As the 5 most valuable companies worldwide (Alphabet, Amazon, Apple, Microsoft, Berkshire Hathaway) show, 4 out of 5 are data- or at least high-tech-related companies. One of the reasons for such high profits is at least the tax avoidance strategy of some of these companies. Since the famous “Double Irish with a Dutch Sandwich”-strategy of some US-Multinational Corporations and the supranational BEPS-reaction it is clear, that taxation in business sectors with high intellectual property proportions leading to low logistical efforts and costs is a question of immense relevance. Conventional businesses are established at a defined place, produce their goods and products there or have clearly defined venues where their service takes place while digital businesses have only some manufacturing sites but are mostly generating their profits and turnovers by intangibles which are not connected to one permanent establishment anymore. With other words: It is clearly definable, where turnover and profits are made in conventional economies. This led to a basic assumption valid for years, stating that taxation of businesses of every kind is connected to kind of a geographic element to allocate the taxation rights to tax authorities. This became law in countless DTTs all over the world as based on the OECD-MC on Double Taxation, according to the meaning of Art. 5 OECD-MC.

As this work will show, current international taxation faces various challenges when it comes to taxation of digital economies which already got tackled by several tools of either international or more nationalistic approaches. The work shall point out the need for a global taxation model for digital economies that is compatible to the fast-changing processes in the digital economy’s world. Additionally to the assessment of the given approaches to tax conventional economies in the light of the particularities of digital economies, this work shall evaluate the international and nationalistic approaches expressed by the OECD, G20 and EU as well as some states within the EU that are pushing forward a national digital tax (e.g. Austria) and shall show detailed approaches and the possible effects on this challenge that are currently not part of the popular approaches but should be at least considered by authorities.

The work shall describe the economic and practical particularities of digital industries compared to conventional industries and their relevance to taxation as well as pointing out the various value creation mechanisms that are used by the actors in order to define the area in which taxation needs to be developed in the view of these challenges. Furthermore, this work shall describe the approaches of the OECD and the EU and take nationalistic and other elements into account when evaluating the effect of those approaches on the challenge of taxing digital economies.

The aim of the work is to give a critical evaluation on the current approaches. This should be based on the detailed description of such approaches trying to create higher

hurdles for the highly profitable digital industry combined with forum shopping of multinational corporations in low tax countries and setting the spotlight on the background of the problem of taxation in digital economies, where permanent establishments are practically not decisive any longer.

On the basis of these preliminary considerations the academic hypothesis for this work shall be the following: “Are the common taxation procedures and approaches meeting the requirements of a digitalized and globalized world or is there a need for fundamental renewals and if so, which measures could be seen as appropriate?”

Also the aim shall be reached by describing the multi-layered options digital economies offer to companies, connecting it to the problem of base erosion and profit shifting and then showing the approaches of OECD and EU on tackling this problem in the relevant context of digitalization with giving an outline on subsequent detailed descriptions of nationalistic digital tax approaches and other tools.

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List of Abbreviations

ao.	and others
AETR	Average Effective Tax Rate
B2B	Business to business
B2C	Business to customer
BEPS	Base Erosion and Profit Shifting
CIT	Corporate Income Tax
CCCTB	Common Consolidated Corporate Tax Base
DAPE	Dependent Agent Permanent Establishment
DBA	Doppelbesteuerungsabkommen
DEMPE	Development, Enhancement, Maintenance, Protection, Exploitation
DST	Digital Service Tax
DTT	Double Tax Treaty
eg.	For example (exempli gratia)
HTVI	Hard-to-value intangibles
ICT	Information and Communication Technology
IP	Intellectual Property
KBC	Knowledge-based Capital
MAU	Monthly Active User
MLI	Multilateral Instrument
MNC	Multinational Corporation
OECD-MC	OECD-Model-Convention
PE	Permanent Establishment
PSM	Profit Split Method
R&D	Research and Development
SDP	Significant Digital Presence
Sog.	Sogenannt/sogenannte/sogenanntes
TFDE	Task Force on the Digital Economy
vs.	versus
z.B.	zum Beispiel

1. Introduction, problems and aims

The world is currently facing a new development of economies. Digitalization is identified as big driver of growth, development and as a value creating business driver.¹ Digitalization in economies all over the world leads to new challenges for all established business activities in terms of commerce, resources and values and in terms of administrative tasks such as tax and advisory. To understand the challenges for the companies in the digitalized world, it is necessary to explain the opportunities that are given by an increasing use of digital methods in making business.² Therefore, the digital economy (DE)³ needs to be described, in order to distinguish between various business models and to get to know how companies adapt such digital business models that gain values in the digital economies.

When the basic activity of digital economies is clarified, particularities of digital businesses can be described in detail and their particular impact on international taxation can be identified. This can be the phenomenon of network effects³ between users on a platform, single-homing vs. multi-homing⁴ in terms of user behaviour and the value-relevant connections for companies who rely on business models containing these effects. All companies discover new land when they scale up in a digital environment, whether in labour, sales, marketing or tax contexts.

The main focus of this work is laid on the challenges for tax authorities and policy makers who work on a fair and effective tax law in digital economies. Old-established indicators for profit allocation are no longer available for digital business models, for instance place of living (Art. 4 OECD-MC) or permanent establishment (Art. 5 OECD-MC). The tools that are given in the OECD-MC on PE relevant scenarios do not cover the DE business models in general. The virtual

¹ Kofler/Mayr/Schlager, 'Digitalisierung und Betriebsstättenkonzept' (2017), RdW 5b/2017/267, 369.

² OECD (2019), 'Measuring the Digital Transformation: A Roadmap for the Future', 16.

³ OECD (2015), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report', OECD/G20 Base Erosion and Profit Shifting Project, 70, 169ff.

⁴ Choi, 'Tying in two-sided markets with multi-homing', 607.

establishment without physical presence appears as the main problem of international taxation of DE.⁵

It is indicated in statements of international policymakers, representants of the G20 and many nations worldwide, that the allocation of taxing rights for states in terms of the taxation of digital business sectors is not fair nor efficient.⁶ When applying traditional rules, tax authorities need to take account of new business models and their particularities. The characterization of conventional economies as physical is given by involvement of physical goods and services, physical locations for business activities and thus provide conditions for international taxation according to OECD-MC, where the international income is allocated between source and residence country.⁷

The DE is further characterized by intellectual properties' (IP) boundlessness, businesses rely on intangible assets, usage of data and adoption of new business models capturing value from externalities generated by free products.⁸ This is the second issue when comparing the conventional industries and digital economy: raising new challenges on the applicability of physical presence for taxation purposes and the reliance on intangibles.

The highest priority for international policy makers and tax authorities is offering solutions to base erosion and profit shifting (BEPS). Companies in the digital economy are benefiting from lower hurdles for effective tax planning what often results in BEPS.⁹ A famous case was the "Double Irish with a Dutch sandwich" used by Google, which allowed Google to save 21.8 Bil-

⁵ Zichittella 'International Initiatives in Addressing Challenges Posed by the Digital Economy' in Kerschner/Somare (eds), *Taxation in a global Digital Economy* (2017), 5.

⁶ OECD (2015), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report', OECD/G20 Base Erosion and Profit Shifting Project, 16.

⁷ Jinyan Li, 'Protection of Tax Base in Digital Economy' [2018] Vol.13/Issue 17, 480.

⁸ Jinyan Li, 'Protection of Tax Base in Digital Economy' [2018] Vol.13/Issue 17, 480.

⁹ Kofler/Mayr/Schlager, 'Digitalisierung und Betriebsstättenkonzept' (2017), RdW 5b/2017/267, 372.

lion EUR from taxes in 2018.¹⁰ BEPS is not a digital economy's exclusive problem, but the digital economy's structures are more likely favouring BEPS, as to be shown in this work.

Addressing the problem of BEPS is the aim of the OECD, set out in the 15 action points¹¹ of the BEPS Project which was launched in 2013.¹² The reports that were published since the start of the project address different subtopics and summarize in the final reports in 2015, starting with the report on BEPS Action 1 "Addressing the Tax Challenges of the Digital Economy".¹³ In 2018, the "Task Force on the Digital Economy" (TFDE) published the latest Interim Report on the developments and the output of the TFDE's work.¹⁴

Not only the G20 members request solution approaches from the OECD, but also the EU came across with two proposals of how to tackle BEPS in digital economy, published on 21 March 2018¹⁵. They have in common that they are aiming at the aggressive tax planning opportunities companies have in the context of digital business models. The basic difference between the two approaches is, that the EU wants to implement a new tax law while the OECD is proposing amendments to the OECD-MC.

The main outcome of the work shall be the dogmatic discussion of the existing international tax law in the context of digital business models. The law has a central connection point with the physical presence of undertakings to make them subject to tax law, it is at least questionable

¹⁰ Sterling, 'Google to end 'Double Irish, Dutch sandwich' tax scheme' (2019) Reuters, <<https://www.reuters.com/article/us-google-taxes-netherlands/google-to-end-double-irish-dutch-sandwich-tax-scheme-idUSKBN1YZ10Z>> accessed 30 June 2020.

¹¹ OECD (2013a), 'Action Plan on Base Erosion and Profit Shifting', OECD Publishing, Paris.

¹² OECD (2013b), 'Addressing Base Erosion and Profit Shifting', OECD Publishing, Paris.

¹³ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', OECD Publishing, Paris.

¹⁴ OECD (2018), 'Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project', OECD Publishing, Paris.

¹⁵ European Commission, 'Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence', 21.03.2020, COM(2018) 147 final;

European Commission, 'Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services', 21.03.2020, COM(2018), 148 final.

whether or not digital business models fit in this requirement and if not, what a possible solution could look like. Therefore, it is indispensable to explain the digital economy and its particularities, the various business models and the challenges arising.

Furthermore, an assessment of existing transfer pricing rules is made. This step should aim at the question if these rules match all the requirements of businesses which rely heavily on intangibles. When the differences between current frameworks and required solution are clear, the approaches of the global community and of the European Union can be assessed.

2. Method for the final assessment

In order to provide a sufficient answer to the hypothesis of this work criteria for a comparative and final assessment need to be defined. Asking “*Are the common taxation procedures and approaches meeting the requirements of a digitalized and globalized world or is there a need for fundamental renewals and if so, which measures could be seen as appropriate?*” contains implicitly the question, if a certain goal can be reached by the measures that are going to be discussed. The defined goal must be the implementation of a fair and effective global taxation of the digital economy and other sectors.¹⁶

The DE comes along with various challenges that need to be met in total when providing a solution. That means, that the approach will be seen as suitable if the challenges of the DE are addressed in this approach and all particularities of the sector are taken into account. This is also about transparency in the meaning of a reasonable explanation why particular businesses are part of the scope of the amendments and others are not.

Besides the requirements of the digital businesses, solutions must contain a practicable element that includes adequateness of the measures to result in a fair and effective taxation. The imple-

¹⁶ Remarks by Angel Gurría, Secretary-General of the OECD, Moscow, 20 July 2013
<<https://www.oecd.org/about/secretary-general/joint-action-efficient-fair-taxation.htm>> accessed 30 June 2020.

mentation, calculated costs connected to the implementation and time periods for implementation scenarios have to be taken into account for the assessment of adequateness.

The last element for the evaluation of the approaches is about potentials that the work on the particular fields brought with it, how the policymakers worked the potentials out and where they missed to make important points a subject of discussion.

3. Digital Economy

It is necessary to clearly define the economic terms and technical processes of the digital economy before focusing on their relevance for tax policies. Opening a comparative basis for conventional and digital economies challenges on taxation can only be made, when the conditions of the DE are thematised and it is pointed out, where the main differences for taxation appear.

Digitalisation is progressively branching out and boosting productivity across all sectors and industries.¹⁷ Besides the development in conventional industries, a new economy based on innovative business models established itself and gained considerable prosperity growth rates and revenues within a very short period of time.¹⁸ The idea of an economy, that can be considered as autonomous, is misleading. More precise is the consideration of a digital economy as the economy itself.¹⁹ Consequently, defining the phenomena of a digital economy as “digitalization of economy”²⁰ is the right term while the digital economy is the industry on information and communication technology (ICT). To describe the functioning of ICT economy, the use of “layers”

¹⁷ Mühleisen, ‘The Long and Short of The Digital Revolution - Smart policies can alleviate the short-term pain of technological disruption and pave the way for long-term gain’, (IMF Finance & Development 2018), Vol. 55, 6.

¹⁸ <<https://www.statista.com/statistics/255970/global-big-data-market-forecast-by-segment/>> accessed 30 June 2020.

¹⁹ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 11.

²⁰ V. Bendlinger, Die Besteuerung der Digital Economy – Eine kritische Würdigung, StAW 2018, 127; with further evidence.

shall categorize the relationships in the digitalized world.²¹ These layers are defined as “Infrastructure”, “Software Resources”, “Accessibility”, “Application”, “User Interface” and “User”. The infrastructure can be understood as physical infrastructure such as router and cables that are guaranteeing the functioning of data transfer. The organization of data transfer is made by servers, which are connected in global data centres. Those two layers are combined through software resources and allow the placement of applications, which are implementing a user interface to create access for users.²²

a. Business Models

Conventional global economies dealt with traditional business models like industrial producing, trade of goods and services that were all available in global markets. But still, market participants seek for improvement potentials and found them in the implementation of digital infrastructures or in the “translation” of traditional business models into modern, digitalized business models with a similar core activity. This leads to a higher mobility and global availability for lower costs at a higher efficiency with regard to economic resources.

²¹ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’.

²² OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 46ff.; Pfister, ‘Die Besteuerung der digitalen Wirtschaft: Implikationen auf die Steuersouveränität und auf die Steuerverteilungsnormen’, (Dissertation University of Zurich 2019), 7.

i. Data-driven business model categories (quantitative categorization)

6 characteristics can be found in many business models of digitalized industries, these features may not all be present at the same time in any particular business, but they increasingly characterize the modern economy.²³

Digitalized economies allow global interactions between companies, personell is not required to be physically present and servers are not necessary locally fixed. Summarised by the term “mobility” of users, data and intangibles, the first characteristic is given that can be found in nearly every digital business model.

Digital Economy is furthermore characterized by a heavy “reliance on data”, as the collected, allocated and analysed amounts of data (“Big Data”) show.²⁴ Some business models are relying on data analytics, what seems exemplary for the idea of what new business models bring along.

“Network effects” describe a psychological phenomenon that occurs with users and influences the rational decision-making process (the more active users on a platform, the more attractive the platform).²⁵ This can increase the value of the platform and of the services provided by the platform host. Such service can be manifold, there are many business models that participate in more than one market at a time. As Noble Price Winner Jean Tirole discusses, multi-sided markets (or “two-sided markets”) are conceptually related to the theories of network externalities and of multi-product pricing.²⁶ The user of a multi-sided market platform is not internalizing the welfare impact of his use of the platform and on other users.²⁷ Such effects can be explained by many different examples, in the context of digital economy the business of social media platforms fits

²³ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 64, 151.

²⁴ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 68, 164ff.

²⁵ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 70, 169ff.

²⁶ Tirole, Rochet (2004), *Two-Sided Markets: An Overview*, 3.

²⁷ Ibid.

well: A platform attracts users, when it is already popular and many other users are members. The more users sign up for the platform, the higher the value of advertisements placed on the platform. But this effect is not internalized in the decision of a user to register for the platform or not. The pricing of the same product is handled on two levels, resulting in one market with different participation conditions. On the one hand, there is the user participation for free or at least a very small price, on the other hand there is the offer for advertisers for higher prices. The higher the network effects of the platform (the attraction rate for new users and possible customers), the higher the prices for the advertiser to place ads in this market.

In some situations, a dominant position can be established by a first mover within a short period of time, when network effects and low incremental costs come together on an immature market.²⁸ Placing a competitive, for instance, platform business model in the same market is always connected with transaction costs for users (to possibly change the platform), which are correlating to the network effects on the platform itself, resulting in the perpetuation of the dominant position. In the digital economy, network effects are often affecting the market simultaneously, leading to the establishment of subsequent markets that are lowering the monopolizing effect of the origin market by using lower entry barriers.²⁹ This complex effect and antitrust-related feature is to be summed up as “Tendency toward monopoly or oligopoly” in digital economy, but shall not be further discussed in this work.

The last characterizing feature of digital economy is “volatility” of the markets itself. The increasing performance of technical products and the fast pace of innovation makes the markets very short-timed and leads to rapid losses of market shares, if sustainable business actions are

²⁸ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 73, 178.

²⁹ Ibid.

not instantly implemented by the actors.³⁰ Measures to be taken can be the acquisition of start-ups in a related field or the development of modified products in order to maintain a market dominance.³¹

In fact, the tendency towards monopoly or oligopoly is aiming at big platforms and search engines where network effects have a significant impact on the success of the business model while the volatility is a matter for tech-related business models where the quality of the technology is the decisive issue.³²

ii. Data-driven business model categories (qualitative categorization)

Business models in the DE can take on new and unprecedented forms. A general distinction of digital business models can be made in a qualitative way of analysis.³³ The focus on the qualitative analysis of the digital business models is reasonable, because the general idea of the OECD, to tax company profits, needs to be linked to the explicitly defined point in the value chain, where profits actually emerge. Before defining these points in the value chains, the different data-driven business models need to be cleared.

Digitalized business can be made without any physical presence and in a border-crossing way. Value is created by companies in many jurisdictions by including many foreign users' participation without being physically present in these market jurisdictions, what is stated as "Cross-jurisdictional scale without mass".³⁴ Next to the redundant physical establishment for those business models, the "reliance on intangible assets, including property" is characteristic.³⁵ Business

³⁰ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 73, 179.

³¹ Ibid.

³² V. Bendlinger, *Die Besteuerung der Digital Economy – Eine kritische Würdigung*, StAW 2018, 128.

³³ OECD (2018), 'Tax Challenges Arising from Digitalisation – Interim Report 2018', OECD Publishing, Paris.

³⁴ OECD (2018), 'Tax Challenges Arising from Digitalisation – Interim Report 2018', 24, 33.

³⁵ OECD (2018), 'Tax Challenges Arising from Digitalisation – Interim Report 2018', 24, 34.

models rely on intangible assets such as codes, algorithms, websites, rights and licenses and many more, implementing the benefits of higher mobility of intangibles and IP at low transaction costs. The third feature is “Data, user participation and their synergies with IP”, meaning the development of an economic resource out of simple data sets by setting a context-based value creation mechanism around the data mining tool.³⁶ The synergy of the effects as described above (eg. network effects) arise out of the direct use of data analytics and can be used in different ways by the companies, meaning their values can be implemented in various forms.

Following the interpretation of the TFDE, business models in this context can be distinguished as “Multi-sided platforms or two-sided markets”, “Reseller” businesses, “vertically integrated firms” and “Input seller” businesses.³⁷

This distinction is based on the works of Rochet and Tirole in 2003 and 2006 as well as on Hagiu and Wright in 2015. The main element of this categorization is the centralistic position of the user participation in the value creating mechanisms on the one hand, being affected by the various activities of companies in the digitalized markets in the other hand. In this interpretation, multi-sided platforms are not only “marketplaces”, where indirect network effects affect price structures across market sides³⁸, but seen as a business model where users can interact in the meaning of concluding contracts or operate transactions on their own.³⁹ The provision of the platform has only indirect impact on the value that is created itself, so the contribution by the users’ activities is the key element and holds the main responsibility for the process. This is, where the centralistic element of the user participation is set.

³⁶ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 24, 35.

³⁷ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 30, 58.

³⁸ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 30, 57.; Tirole, Rochet (2003), ‘Platform Competition in Multi-Sided Markets’.

³⁹ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 30, 57; Hagiu, Wright (2015a), ‘Marketplace or Reseller?’; Hagiu, Wright (2015b), ‘Multi-sided platforms’, International Journal of Industrial Organization’.

“Reseller” in the digital economy rely their business activities on the production of goods and services by others and sell them to customers through a digital infrastructure. Their business model can be categorized as single-sided market.⁴⁰ The user is not participating in the value creating mechanism in this business model. The reseller controls prices and assumes liability towards customers.⁴¹

“Vertically integrated firms” in this context are businesses with own suppliers which integrated their contribution to the value chain in their business models by using the digital infrastructure or typical goods and services belonging to the digitalized economy (e.g. intangibles, e-commerce, cloud computing).⁴²

“Input suppliers” contribute partly inputs to the value creation chain, they only interact with other firms but not with the final customer.⁴³ To summarize, the only business model category in digital economy, in which the user makes an important contribution to the value creation, is the multi-sided platform business model. This was the incentive for the TFDE to concentrate on the functioning of such platforms, knowing, that other business models can still be existent in the same corporation but in other entities.

b. Value creation mechanisms in digital economy

The examination of the underlying value creation mechanisms in the light of user participation based business models in the digital economy is made by the use of subsequent categories of value creation mechanisms.⁴⁴

⁴⁰ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 30, 58.

⁴¹ Ibid.

⁴² Ibid.

⁴³ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 31, 58.

⁴⁴ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 35, 66ff.

Aiming at the point where the factual value is created in the value chain, the first pillar is the value chain, a model based on Thompson in 1967⁴⁵, showing “where the value is created by converting inputs into outputs through discrete but related, sequential activities (each of which can be thought of as a production function).”⁴⁶ This mechanism is mostly applied in traditional, vertical integrated manufacturing firms producing tangible goods but also any other firms operating linear production processes aimed at producing intangible goods or services.⁴⁷ It is also applicable to resellers operating websites for various tangible and intangible products and input suppliers.⁴⁸

Higher digitalized businesses are categorized by the term “value network”,⁴⁹ using a mediating technology to link customers interested in engaging in a transaction or relationship.⁵⁰ This is often provided by platform operators, letting individuals connect with each other while allowing advertisers to target specific user groups.⁵¹ Such platforms are often categorized as multi-sided markets, the non-neutral pricing mechanism allows the operators to price below marginal cost on the one side of the market (eg. for users) but raises costs on the other side (eg. for advertisers).⁵² Revenue in value networks can be generated by subscription fees or “pay-as-you-go-fees” when the service is consumed.⁵³ The TFDE points out the user participation as an “input valuable to the platform operator” in the form of personal information about the user’s interests what can be

⁴⁵ Thompson (1967), *Organizations in action: a social science bases of administrative theory*, Transaction Publishers.

⁴⁶ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 36, 74.

⁴⁷ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 37, 79

⁴⁸ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 38, 77.

⁴⁹ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 38, 81.

⁵⁰ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 38, 80.

⁵¹ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 38, 82.

⁵² OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 39, 87.

⁵³ Ibid.

used to generate target advertisement turnovers.⁵⁴ E-Commerce intermediaries, collaborative consumption firms and social networks use the value network approach.⁵⁵

Not all businesses are highly digitalized, some are just using highly digitalized technology to solve specific customer demands.⁵⁶ These “value shops” are operating classic single-sided markets.⁵⁷ The problem of the customer is digitalization-related, so the value creation lies in solving a problem on a digital field.⁵⁸ This mechanism is used by cloud-computing firms and vertically-integrated professional service firms.⁵⁹ Value shops do not rely on user participation in the value creation process.

c. Digital economies’ challenges for taxation

The particularities of the DE, the new business models and the value creation mechanisms result in new challenges for international taxation of company profits, more precise in new challenges for the corporate income tax.⁶⁰ The challenges can be summed up as Nexus, Data and Characterization of value creators.⁶¹ The categories are linked to the question, whether or not the current international tax framework is still appropriate to deal with the changes that come with the DE and the business models that are operated.⁶² The reliance on data and intangibles in general

⁵⁴ Ibid.

⁵⁵ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 40, 88.

⁵⁶ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 40, 89.

⁵⁷ Ibid.

⁵⁸ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 40, 91.

⁵⁹ OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 41, 97.

⁶⁰ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 99, 250.

⁶¹ Zacher, *Transfer Pricing and Value Creation in a digitalized economy*, p. 481; OECD (2018), ‘Tax Challenges Arising from Digitalisation – Interim Report 2018’, 24.

⁶² OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 99, 249.

might be the predominant challenge⁶³, because it is at least causing subcategories of challenges for international taxation on nexus and characterization issues.

i. Nexus issues and the physical establishment

Nexus means the physical establishment of a company in a jurisdiction as a link for the allocation of taxing rights. The issue describes a lack of physical establishments of companies operating one of the digital business models and is followed by the question, whether or not the current rules to determine nexus in a jurisdiction for tax purposes are appropriate for DE.⁶⁴ This is followed by the discussion about the ability of having a significant digital presence without being liable to tax.

The core activities of every business are generating profits by sourcing and acquiring inputs, creating or adding values and selling goods and services to customers as well as doing market research, marketing and advertising and supporting services. In digital industries, compared to conventional industries, this is made at higher speed regarding the processing, analysis and utilization of information.⁶⁵ Consequently, the number of potential customers increases due to the easier overcoming of distances in the digital space.⁶⁶ The performance of certain cross-border-processes can now be carried out remotely or by automated equipment, altering the relevance of staff activities on site first.⁶⁷ This can also be illustrated by decision-making processes or contracting that are carried out by algorithms and software programs.⁶⁸

⁶³ Zacher, *Transfer Pricing and Value Creation in a digitalized economy*, 481.

⁶⁴ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 99, 248.

⁶⁵ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 100, 253.

⁶⁶ Ibid.

⁶⁷ Ibid.

⁶⁸ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 100, 254.

Another possible way of being present in foreign markets is illustrated by the data collection through mobile devices. Users collect the data themselves, allowing the value network company to access their data and to process it. The implementation of the data in the value creation mechanism might be done later and at a different location. But without the contribution of the user to the value chain there would be no sale of advertisement at a higher price for this business. This is why there must be a clear identification of the origin of the value drivers to grant a fair attribution of the profits to the particular countries where the profits actually emerge.

All in all, participation in a market that is not located in your home jurisdiction is easier in digitalized businesses and more popular when operating a digital business model. The opportunity of participating in a foreign country's economic life without having a permanent establishment there was already taken into account for the activities of dependent agents, Art. 5 (5) and (6) OECD-MC. This reflected business models without any digital background, the application of Art. 5 (5) and (6) OECD-MC seems to be outdated for DE. Nevertheless, the ability of concluding contracts on remote through digital tools shows how activities can be taken out in the digital economy and that the idea of a taxable nexus might not be generally applicable for all businesses any longer. Some businesses rely on user participation and networking effects for their particular value creation instead of contracting through digital interfaces, as shown above.

The challenge is to define the concrete place of value creation.⁶⁹ When, for instance, network effects consequently increase the potential monetary value of a value network without having a real interaction between users, there must be a clearly defined location accessible for taxation purposes.⁷⁰ At the same time, the contribution of user-created content, that also leads to increasing values and which is monetized via the mechanisms of multi-sided markets at a subsequent

⁶⁹ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 101, 257.

⁷⁰ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 101, 257.

point of time in the value chain and in a different interaction of different actors, needs to be assessed as taxable. The origin of this income in form of digital resources must be attributable to particular locations by certain characteristics. The current connection of valuable content contribution, monetization of content and clearly definable location is prone to error.⁷¹ Moreover, relevance of former excepted business activities in relation to the definition of PE became more significant, meaning that it has to be evaluated again, whether or not a business establishment is a core activity of the operator or just of preparatory character.⁷²

All in all, the dependence from a physical establishment in the market where companies are operating has become less intense, even for companies in traditional industries that use digital tools and services.⁷³ This shows that the existing methods of defining a nexus for taxable income is one main challenge for international taxation.

ii. Reliance on Data and value creation with Data

Digital economy is heavily relying on the use of data. Data has become an economic resource and therefore needs to be considered in relation to tax law in form of valuing data as asset to make it relevant for tax results or not.⁷⁴ Digitalized business models use different ways to collect, process, analyse and finally monetize data, it is even possible to purchase data. Data can also be contributed to the particular value creation mechanism by the user.

The tax relevant treatment of data is connected with its heritage. Purchased data is easily treated as asset and will thereby appear on accounting sheets while self-collected data can be treated like

⁷¹ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 101, 258.

⁷² OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 101, 260.

⁷³ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 101, 258.

⁷⁴ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 103, 263.

other self-created intangibles which will not necessarily appear on balance sheets.⁷⁵ The data and intangibles cannot be valued transparently by third parties, that opens opportunities for BEPS in the meaning of transfer pricing issues.

In some cases, data is attributable to a PE of a local subsidiary, in other cases data is not attributable to a foreign enterprise and thereby without any PE in the market jurisdiction. Sometimes, data collection is made by users themselves through the use of technology (eg. location data, health data). This puts pressure on the nexus issues since the final location of data collection is not clearly definable.⁷⁶

Next to the collection of data, the processing of data is relevant in taxation questions. The processing of collected data in a foreign country with the purpose to use it for a later implementation in the value chain in the domestic country can cause nexus issues and is thereby a scenario of tax law relevance that cannot be solved fairly on the basis of existing tax rules. Scenarios like this show that international tax law needs amendments of existing rules to finally cover all particularities of cross-border business activities in DE. Defining the concrete point of value creation could be one technical solution in this particular point.

More generally speaking, the cross-border attribution of profits to single functions in the value chain raises questions in particular in the context of taxation of digital economy.⁷⁷ The challenge of determining the appropriate allocation of profits among countries is also given for multi-sided markets, where customers are spread over more than one country.⁷⁸ To overcome this basic issue, it could be solved in a way that the customers' and the users' data heritages are at least

⁷⁵ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 103, 263; Zacher, *Transfer Pricing and Value Creation in a digitalized economy*, 482 f.

⁷⁶ Ibid.

⁷⁷ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 103, 265.

⁷⁸ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 104, 266.

linked at the point, where data's value is reflected in the advertising revenue generated in a country.⁷⁹ This challenge exists also for business models, where the value creation relies only on the users' participation without being reflected by downstream profit generation.

The last issue that comes with the attribution of data for tax purposes is the correct classification of transactions.⁸⁰ The questions arise out of structures, where transactions are based on data exchange followed by the question to which extent data can be considered a free good.⁸¹ A transparent valuation of data and intangibles could be the basis for a fair allocation of profits.

As long as businesses in the digital economy are facing low logistical effort and low market entry barriers, investments in intangible assets are profit promising business models.⁸² The taxation of businesses implementing the use of intangibles is challenged by the valuation of intangibles and the transfer of intangibles in low tax jurisdictions, which is done by the digital businesses without high logistical effort at low costs. Solutions on valuation and on transfer pricing rules can be a promising addition to the definition of the location of value creation and the consideration of business models, where the PE issue is combined with the reliance on intangibles.

iii. Characterization of value creators

Digital economy actors use different distribution channels for their goods and services compared to traditional industries. Profits are generated at different points in the value creation chain, even profit generation at more than one point of the value creation chain is possible (eg. multi-sided markets). Those new channels lead to new questions for taxation in order to classify the pay-

⁷⁹ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 104, 266.

⁸⁰ Ibid.

⁸¹ Ibid.

⁸² Richter, Hontheim, 'Double Irish with a Dutch Sandwich: Pikante Steuergestaltung der US-Konzerne', (2013), DB Nr. 23, 1260 (1260).

ments in such structures,⁸³ and in relation to particular cases, where the treatment of services and goods is causing uncertainty about the fairness and equality of the treatment.⁸⁴

The characterization of transactions as business profits or eg. as royalties and thereby attributing them to corporate income tax or withholding tax (WHT) depends on the applicable tax treaty. This may cause inequality for businesses, where generated profits through a PE in a particular market jurisdiction are subject to taxation on a net basis, while the competitor is generating profits in the same market without PE and is not subject to taxation because the profits are characterised as eg. licensing payments to the mother entity of the corporation in a low tax country. The characterisation of digital business activities needs to be covered by tax law in order to prevent distortions of competition in the markets. A uniform modification of PE thresholds and associated profit attribution rules could permit such unfair taxation while source taxation could also be ensured by the creation of a new income category that is subject to WHT.⁸⁵

d. Tax avoidance in digital economy

The problem of base erosion and profit shifting in DE is classified in the OECD Final Report on BEPS Action 1 in four main avoidance structures. The first strategy is “Eliminating or reducing of tax burden in the market country”. This can be achieved by merging three elements: avoiding a taxable presence⁸⁶, minimizing the income allocable to functions, assets and risks in market

⁸³ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 104, 268.

⁸⁴ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 104, 269.

⁸⁵ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 104, 272.

⁸⁶ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 79, 184f.

jurisdictions⁸⁷ and maximizing deductions in market jurisdictions⁸⁸. The use of a digital economy business model lowers the barriers to interact with customers in another country without having a physical presence there. This is also possible for conventional economies, but the use of automatized processes and a general decrease of reliance on physical presence in such market jurisdictions makes it available to a greater scale to Multinational Corporations (MNCs) to earn revenue from customers without having a physical establishment in the customers' country.⁸⁹ Art. 5 and 7 OECD-MC state, that a company is only subject to tax in a foreign country when a physical establishment in such country is established.⁹⁰ The second element is minimizing the income allocable to functions, assets and risks in market jurisdictions, meaning intangibles and risks are carried out at the local level and allocated to other group entities through contractual structures, ideally to entities operating in low-tax environments.⁹¹ The third element of the strategy is maximizing of deductions in market jurisdictions.⁹² Depending on the market jurisdictions, MNCs can use rules on deductions to reduce the taxable income in form of interest, royalties, service fees and others.⁹³

Another strategy used by MNCs in this context is "Avoidance and minimization of withholding tax".⁹⁴ A company, that is subject to withholding tax can be entitled by treaty to reduced or ex-

⁸⁷ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 80, 186 ff.

⁸⁸ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 80, 189.

⁸⁹ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 79, 184f.

⁹⁰ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 79, 184.

⁹¹ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 80, 186f.

⁹² OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 80, 189.

⁹³ Ibid.

⁹⁴ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 81, 190.

empted withholding tax on payments of profits to a low tax jurisdiction in form of royalties or interests.⁹⁵ The practice is called “treaty shopping” and needs an infrastructure of companies in countries with beneficial tax treaties for such purposes. Companies in the digital economy can use this interface more easily, because the requirements for these businesses are not as strictly connected to physical presences as it is in conventional industries.⁹⁶

The third strategy is about “Elimination or reducing of tax in the intermediate country” and is enabled by the application of a preferential domestic tax regime, the use of so called “hybrid mismatch agreements” or by excessive deductible payments sent to connected companies in low tax jurisdictions.⁹⁷ More generally speaking, the allocation of income to low tax jurisdictions of the company is the key for benefiting from different tax treaties. Business functions in this context are not linked with “hard factors” like skilled labour or necessary resources any longer but grow increasingly mobile, making the allocation of taxable income more advantageous for MNCs in the digital economy.⁹⁸ At the same time, the low logistical effort that is used to transfer IP and intangibles in general is the particularity of digital economy that is used by the companies to benefit from this strategy.

The fourth BEPS strategy is “Avoidance and reduction of taxation in the country of residence of the ultimate parent”.⁹⁹ This means that the taxable income of the company is reduced in the country where the parent company is established by applying the techniques mentioned above for the purpose of reducing the tax burden of the parent company instead of applying it for the

⁹⁵ Ibid.

⁹⁶ Shown above.

⁹⁷ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 81, 191.

⁹⁸ Ibid.

⁹⁹ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 82, 195f.

purpose of reducing taxable income in market country jurisdiction.¹⁰⁰ Contractual allocation of risks and legal ownership of mobile assets such as intangibles and IP to group entities in low tax jurisdictions is going hand in hand with a systematically undervalued function of parent entities in high tax jurisdictions.¹⁰¹ Deferral systems for foreign-source income, missing rules on connected foreign companies and inadequate coverage of certain categories of passive or mobile income in respect to intangibles open the doors for companies to avoid taxation in domestic jurisdictions by overcoming the tax obligation of the parent company.¹⁰²

4. Global solution approaches for the tax challenges of the digital economy

The DE comes with a wide range of new challenges and some are directly entering the discussion of tax policy changes. The avoidance of physical establishments is one point that needs to be covered by the tax law, at least the changing business drivers of lower marginal costs in combination with increasing network effects and a high level of user participation on multiple levels may justify tax policy changes.¹⁰³

The OECD published the final reports of the BEPS-Project and discusses possible amendments to the existing international tax law to take the impact of the DE on the global economy into account. One of the BEPS Action Plan's goal is to find solutions to the mentioned challenges and to tackle the systematic tax avoidance in digital economy. In other words, untaxed stateless in-

¹⁰⁰ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 82, 195.

¹⁰¹ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 82, 196.

¹⁰² OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 82, 196.

¹⁰³ Pistone and Hongler (2015), 'Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy', (IBFD Working Paper, 20 January 2015), 2.

come shall be put to an end.¹⁰⁴ The 15 Actions in the Plan are covering different aspects of international taxation, discussing and guiding to renewals in the several subtopics. The OECD is the global organization on which model convention most Double Tax Treaties (DTTs) are based, the discussion of the BEPS-Project is central to assess the impact of DE on international taxation.

The main challenge seems to be connected to nexus questions as there is the source country principle not as easy to apply for digital and digitalized business models. The conditions of DE enable MNCs to participate in markets without any physical presence in the market jurisdiction and hence to avoid a PE status there.¹⁰⁵ Here it is to discuss what approaches the OECD put forward to make nexus concerns subject to the renewals and whether the measures were expedient to make DE subject to fair and effective international taxation. Action 7, which is focusing on the artificial avoidance of the PE status, includes the measures in order to counteract the current development in DE by taking nexus issues into account.

The subsequent question is about allocation of profits in MNCs operating digital and digitalized business models. The avoidance and deduction of taxable income by benefiting from treaties and by the increasing reliance on intangibles as such lead to issues in the field of transfer pricing, where MNCs are locating their intangibles at advantageous locations by using structures like license agreements, separation of deductions or cost contribution agreements. To provide definitions of intangibles for transfer pricing purposes and to provide a guiding framework for transfer pricing in DE, Actions 8 – 10 were set up by the OECD.

¹⁰⁴ See also OECD (2015b), ‚Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project‘, 9.

¹⁰⁵ OECD (2015a), ‚Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project‘, 100 ff; Endo (2019) in Kerschner/Somare, ‚Modification of a Taxable Nexus to Address the Tax Challenges of the Digital Economy‘, 106.

The assessment, whether the OECD measures reflect the named challenges efficiently and if they provide sustainable protection against the tax avoidance needs to take the Actions on related fields into account, namely Action 3, Action 5 and Action 6.

a. Artificial avoidance of PE status

Businesses in the DE do not necessarily run permanent establishments in the market jurisdictions where they are active. Scenarios, where the permanent establishment of a company is at least questionable, have already been mentioned in the OECD-MC. It is questionable, if these tools are already covering the particularities of digitalized businesses or if there is a need for amendments.

The core provision for taxation of business profits in cross-border transactions is given in Art. 5 OECD-MC. Profits 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. But the source country of the company operating in the cross-border transaction can have the unlimited taxing right as well, if the profits are generated through a permanent establishment, Art. 7 (1) OECD-MC. The application of credit or exemption method can grant reliefs to the resident country for the purpose of avoiding double taxation. In order to prevent tax avoidance strategies on the behalf of some structural legislative flaws in the tax system, Action 7 of the BEPS Action Plan focuses on a solution for artificial avoidance of the PE status.¹⁰⁶

Permanent establishment in the sense of Art. 5 (1) OECD-MC is a fixed place of business through which the business is wholly or partly carried on. Art. 5 (2) OECD-MC outlines examples for the PE status while Art. 5 (4) OECD-MC points out a list of negative examples for activities that are not entailing PE status. Art. 5 (5) to Art. 5 (7) OECD-MC are focusing on depend-

¹⁰⁶ Atanasov (2017), 'Permanent establishment 2.0 – Is it time for an update?', 14.

ent agents and commissionaire agreements, instruments that could be used to undermine the general aim of Art. 5 OECD-MC. Art. 5 (8) contains definitions and interpretations on relevant terms.

i. Art. 5 (5) and (6) OECD-MC: Dependent Agents and Commissionaire Agreements

Contracting in other jurisdictions than your home jurisdiction can be done by the use of agent structures in the business model. It seems reasonable to assess whether DE businesses are generating profits by the use of dependent agents in the meaning of Art. 5 (5) OECD-MC. Chapter A of Action 7 of the OECD BEPS-Project discusses the Art. 5 (5) OECD-MC and points out the relevance for DE already in the executive summary.¹⁰⁷

According to Art. 5 (5) OECD-MC, a dependent agent forms a permanent establishment, even when he is employed by a foreign company. A dependent agent permanent establishment (DAPE) is characterised by any natural or legal person who is not an independent agent (Art. 5 (6) OECD-MC), who works for the enterprise in another state, who has the power of attorney to represent the enterprise and who actually does not carry out any preparatory or auxiliary activities as defined in Art. 5 (4) OECD-MC.¹⁰⁸

DAPE describes a natural or legal person's activity and not a local business entity, meaning that the DAPE is treated like a fictional establishment without any real presence in the market required.¹⁰⁹ The application of this definition on DE business models is obvious, where companies are not present in the market jurisdiction by an establishment but by activity.

¹⁰⁷ OECD (2015b), 'Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 9.

¹⁰⁸ V. Bendlinger (2018), *Die Besteuerung der Digital Economy – Eine kritische Würdigung*, JKU Linz Publishing, 33.

¹⁰⁹ Ibid.

Next to acknowledging DAPE-like structures in the digital economy, the commonly used practices of commissionaire agreements are picked up in Action 7. Commissionaire agreements are arranged between a company and a person selling the company's products in a foreign state on behalf of the company but in its own name.¹¹⁰ The company avoids a PE status in that country but distributes its products without being taxed according to Art. 5 (6) OECD-MC. The commissioner will not be taxed either, because the company is still the legal owner of the products. The only taxed income in that market jurisdiction is the commission for the salesperson. Consequently, the contracts that are closed by the commissioner are not binding on the company in the meaning of Art. 5 (5) OECD-MC and thereby are not subject to corporate income tax.¹¹¹ Similar strategies to avoid Art. 5 (5) OECD-MC are found in situations, where contracts are concluded or finalised abroad but substantially negotiated in a State or where the authorised representative is interpreted as independent agent and therefore constitutes an exception under Art. 5 (4) OECD-MC.¹¹² The amendments of Art. 5 OECD-MC published in Action 7 take Commissionaire Agreements and similar strategies into account. The scope of the contracts where this categorization takes place is widened to transfer of ownership of company property and granting of usage rights. This is an answer on the DE specific ways to conclude sales contracts where IP and other intangibles are subjects of the contracts.

The DAPE-Construct is the current applicable form for allocation of profits when no PE is given.

When further developing the DAPE, the outcome should have been the point where contracting

¹¹⁰ OECD (2015b), 'Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 9.

¹¹¹ OECD (2015b), 'Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 9.

¹¹² OECD (2015b), 'Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 10.

through websites and apps should have been aggregated.¹¹³ But the extended version of Art. 5 (5) – Art. 5 (7) OECD-MC does not qualify the DE businesses as DAPE-Scenarios at all. Some scenarios are conceivable in which commissionaire structures are combined with exceptions of Art. 5 (4) OECD-MC, but even this is not covering all taxable activities in the DE and therefore this way cannot be seen as concrete solution to the taxation of DE.¹¹⁴

ii. Art. 5 (4) OECD-MC and anti-fragmentation

When there is no PE applicable, it has to be cleared whether or not the avoidance of a PE could be classified as one of the exemptions that are stated in Art. 5 (4) OECD-MC. Chapter B of Action 7 is focusing on specific activity exemptions in Art. 5 (4) OECD-MC. It is a list of the business activities that shall not constitute a PE, when this activity is of preparatory or auxiliary character. Preparatory character of an activity is given, when the activity is carried on in contemplation of the carrying on of what constitutes the essential and significant part of the activity of the enterprise as a whole.¹¹⁵ It will be followed by a downstream activity in a relatively short period of time.¹¹⁶ Auxiliary character is given, when the activity is carried out to support, without being part of, the essential and significant part of the activity of the enterprise as a whole.¹¹⁷ The requirement of assets or employees can help identifying the auxiliary character of an activity.¹¹⁸

¹¹³ V. Bendlinger (2018), *Die Besteuerung der Digital Economy – Eine kritische Würdigung*, JKU Linz Publishing, 34.

¹¹⁴ Ibid.

¹¹⁵ OECD (2015b), ‘Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 30, 21.2.

¹¹⁶ OECD (2015b), ‘Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 30, 21.2.

¹¹⁷ Ibid.

¹¹⁸ Ibid.

The DE can subdivide several steps in the value chain, companies source auxiliary and preparatory activities out. Especially in e-commerce business models it is necessary to run huge warehouses and logistic subsidiaries in the different market jurisdictions. The product is ordered online and sent to the customer from these subsidiaries. The profits are originally attributed to the parent company directly as it is qualified as auxiliary activity to manage the logistical background.

The amendments in Chapter B are aiming at exactly this phenomenon. The idea is narrowing the definition of preparatory and auxiliary characters of business activities. This shall take digital business models and the different value creation mechanisms into account. Art. 5 (4) lit. f) OECD-MC enabled MNCs to restructure themselves in order to optimise the tax planning. Changes of this subparagraph aim at this strategy and the idea of fragmenting the business into small activities in order to argue, that these activities are preparatory or auxiliary in the meaning of Art. 5 (4) OECD-MC. As a consequence, all activities of the MNC are taken into calculation and even the location, where the business activities are carried out, are indicating the completion of the business fragments and thereby the formation of the same operation without letting Art. 5 (4) OECD-MC be applicable.¹¹⁹

The qualification of fragmented business activities in the e-commerce as important contribution to the whole value creation mechanism can be seen as an effective way, promising at least a clearer identification of the locations of value creation.

iii. Assessment BEPS Action 7

When concluding the outcome of Action 7, the assessment should point out the efficiency of the measures and further if the amendments are adequate to provide a fair and effective taxation. It is

¹¹⁹ Ibid.

also important to have a look at the potentials that have not been exploited when working on the nexus issues.

A sufficient solution should take account of the challenges of the DE for international taxation (Nexus issues, the data reliance and the characterization of value creators). Action 7 is basically discussing nexus issues, so it must be asked whether this problem is solved sufficiently by the OECD in this point. The answer must be negative. Action 7 concentrates on various business models that can be applied to the DE but not on all of them nor on the DE in general.

The amendments seem to be adequate, but it is questionable if they can be implemented sufficiently and reliably. The OECD drafted a multilateral agreement (MLA) on 24. November 2016 that should implement the amendments on Art. 5 OECD-MC in all OECD-based DTTs.¹²⁰ Art. 13 (2) and (3) MLA gave out a model where contracting states can choose between two options, whether the application shall lead to Art. 5 (4) lit a) – f) being interpreted as auxiliary and preparatory activities or if exemptions of the catalogue are still applicable, notwithstanding the preparatory or auxiliary character of the activity.¹²¹ Art. 13 (4) MLI is further implementing the anti-fragmentation rule to avoid the split by contract within enterprises, see above. There are issues coming up on that due to interpretation concerns and misuse of the clause. Scholars show, that the approximately 22 % of all DTTs are affected by the implementation of Art. 13 (4) MLI.¹²²

The last point of the assessment is about the potentials of the amendments. As seen above, a great step forward could be a clear definition of the location where value is created in digital business models. Another potential could have been a clear definition of nexus for the DE. The definition of a PE and thereby the allocation of an exclusive taxing right is not possible under the

¹²⁰ V. Bendlinger (2018), *Die Besteuerung der Digital Economy – Eine kritische Würdigung*, JKU Linz Publishing, 31.

¹²¹ Ibid.

¹²² Ibid.

application of Post-BEPS legislation.¹²³ The solution shall focus on the ability of businesses to derive sales from a country without having a PE there and to use of contributions of users to the value chain and to monetize it.¹²⁴

The proposed amendments in Action 7 should have addressed exactly the tax avoidance strategies to finally interrupt the use of tax base erosion in the states where sales take place.¹²⁵ All in all, Action 7 is only covering one part of the problem and is not even considering all DE particularities. The PE problem needs to be solved by a more specialised approach, as proposed by other institutions.

b. Valuing intangibles and transaction models

Another issue of tax avoidance in the DE is linked to the business models' reliance on intangibles and user contribution to the value creation mechanisms. The use of intangibles within an MNC offers possibilities to base erosion by non-transparent pricing policies of value creation with data and the disregard of pricing at arm's length principle by transfers of intangibles or rights to tax advantaged jurisdictions.¹²⁶ This is where MNCs can reduce their taxable profits DE specific transactions of intangibles under price. A solution could be given in new transfer pricing rules that take account of the requirements of the DE and in transparent rules on the valuing of intangibles.

¹²³ Sakuth (2019) in Kerschner/Somare, 'The Concept of Corporate Tax Residence in Light of the Digital Economy', p. 93 ff.

¹²⁴ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 106, 273; Endo (2019), 'Modification of a Taxable Nexus to Address the Tax Challenges of the Digital Economy', 109.

¹²⁵ OECD (2015b), 'Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 8.

¹²⁶ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 145, 373.

The OECD Transfer Pricing Guidelines are the basic instrument for international transactions of assets within MNEs and between associated companies. The Guidelines are implemented in most of the OECD countries. Action 8 – 10 aims at the OECD Transfer Pricing Guidelines, amendments are made for transfer pricing issues coming up with the challenge of DE taxation.¹²⁷

Assessing the value of intangibles is complex, many factors have impact on the value structure of the intangibles and are varying from user to user.¹²⁸ The so-called hard-to-value-intangibles (HTVI) on the one hand and special contractual relationships (eg. cost contribution arrangements) on the other hand are faced by BEPS Action 8 – 10. The OECD introduces a functional analysis for the assessment of value creation mechanisms in the context of transfer pricing of intangibles.

The reliance of DE business models on intangibles goes hand in hand with an increase of group-intern transactions of intangibles. The logistic effort of these transactions is very low, the transactions are easily achievable for the MNCs. A transparent attribution of profits to the different entities of the MNCs is followed by a transparent allocation of taxing rights on such transactions. A transparent allocation of taxing rights on such transactions needs to be developed, but group entities still need to be compensated fairly when participating in global value creation mechanisms when they contribute to the development, enhancement, maintenance, protection and exploitation of intangibles (DEMPE).¹²⁹

The evaluation of the state of the discussion on the taxation of profits generated through transactions of intangibles needs an overview over the definitions of intangibles and legal ownership structures, their functions as assets in the DE and the transactions available and used in DE.

¹²⁷ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 12.

¹²⁸ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 102, 262 ff.

¹²⁹ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 145, 373.

When the definitions are cleared, the development of an effective transfer pricing system for DE can be assessed afterwards.

i. Identification and ownership of intangibles

A legal definition of intangibles could prevent difficulties in terms of applying Arm's length principle to transactions between associated enterprises.¹³⁰ According to the OECD, intangible assets are qualified as knowledge-based capital (KBC),¹³¹ such as computerised information (software and databases), innovative property (patents, copyrights, designs, trademarks), and economic competencies (including brand equity, firm-specific human capital, networks of people and institutions, and organisational know-how that increases enterprise efficiency).¹³² The OECD defines intangibles as something which is not a physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated if it had occurred in a transaction between independent parties in comparable circumstances.¹³³

Intangibles exist in various shapes but not all of them are relevant for transfer pricing purposes. Therefore, the OECD recommends a functional analysis of intangibles that should identify the relevant intangibles at issue, the manner in which they contribute to the creation of value in the transactions under review, the important functions performed and specific risks assumed in connection with the development, enhancement, maintenance, protection and exploitation (DEMPE)

¹³⁰ OECD (2015c), 'Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project', 67, 6.5.

¹³¹ Sejati (2019) in Kerschner/Somare, 'Modification of a Taxable Nexus to Address the Tax Challenges of the Digital Economy', 263.

¹³² Sejati (2019) in Kerschner/Somare, 'Modification of a Taxable Nexus to Address the Tax Challenges of the Digital Economy', p. 263; OECD, 'New Sources of Growth, Knowledge-Based Capital Key Analyses and Policy Conclusions Synthesis Report', 12.

¹³³ OECD (2015c), 'Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project', 67, 6.6.

of the intangibles and the manner in which they interact with other intangibles, with tangible assets and with business operations to create value.¹³⁴ This is typically patents, know-how and trade secrets, trademarks, tradenames, brands, rights under contracts and governmental licenses, licenses and other limited rights in intangibles.¹³⁵ It depends on the case, whether group synergies or market specific characteristics are considered as relevant intangibles as well.

The OECD Transfer Pricing Guidelines distinguish between marketing intangibles and trade intangibles. BEPS Action 8 the definition is made more general and broader, for instance the term ‘marketing intangibles’ is added by ‘depending on the context, marketing intangibles may include, for example, trademarks, tradenames, customer lists, customer relationships, and proprietary market and customer data that is used or aids in marketing and selling goods or services to customers’.¹³⁶

The determination of legal ownership in transfer pricing cases is important to allocate the risks on the intangible itself but also to guarantee a compensation for value contribution within the MNC holding ownership rights on a specific intangible.¹³⁷ The ownership of an intangible in general is a key factor in determining where profits should be allocated among the members of a multinational group.¹³⁸ The Transfer Pricing Guidelines are not giving particular rules on identifying legal or economic ownership on intangibles but emphasizes the importance of economic ownership in transfer pricing context.¹³⁹ Action 8 underlines the legal ownership and the contrac-

¹³⁴ OECD (2015c), ‘Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project’, 68, 6.12.

¹³⁵ OECD (2015c), ‘Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project’, 70ff., 6.19 – 6.31.

¹³⁶ Ortiz Gómez (2019) in Kerschner/Somare, ‘Transfer Pricing of Intangibles in the Digital Economy’, p. 287f.

¹³⁷ OECD (2015c), ‘Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project’, 73, 6.32.

¹³⁸ Ortiz Gómez (2019) in Kerschner/Somare, ‘Transfer Pricing of Intangibles in the Digital Economy’, 288.

¹³⁹ Ortiz Gómez (2019) in Kerschner/Somare, ‘Transfer Pricing of Intangibles in the Digital Economy’, 289.

tual agreements as starting point for the analysis of each party's contribution to the value creation mechanism.¹⁴⁰

Legal ownership is conveyed by application, enrolment or registration and/or issuance by the relevant national public body (e.g., national patent and trademark office),¹⁴¹ economic ownership describes the economic contribution of value to an intangible or IP item and makes the contributing party the economic owner.¹⁴²

The determination of legal ownership and contractual arrangement needs to be treated separate from compensation issues under arm's length principle.¹⁴³ Legal ownership alone does not constitute a right to retain profits from the exploitation of an intangible, even though such profits may initially accrue to the legal owner as a result of his legal or contractual right to exploit the intangible.¹⁴⁴ The right to retain profits is linked to the function of the performance, the used assets, the assumed risks and generally upon the contributions made by other group members.¹⁴⁵ The return ultimately retained by or attributed to the legal owner depends upon the functions it performs, the assets it uses, and the risks it assumes, and upon the contributions made by other MNC group members through their functions performed, assets used, and risks assumed.

ii. Functions, Assets and Risks

Besides the ownership, the OECD discusses the determination of the appropriate remuneration to the members of a group for their functions, assets, and risks as the second step of the analysis of

¹⁴⁰ OECD (2015c), 'Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project', 76, 6.42.

¹⁴¹ Ortiz Gómez (2019) in Kerschner/Somare, 'Transfer Pricing of Intangibles in the Digital Economy', 288.

¹⁴² Ortiz Gómez (2019) in Kerschner/Somare, 'Transfer Pricing of Intangibles in the Digital Economy', 289.

¹⁴³ Ibid.

¹⁴⁴ Ortiz Gómez (2019) in Kerschner/Somare, 'Transfer Pricing of Intangibles in the Digital Economy', 289.

¹⁴⁵ Ibid.

the remuneration under the arm's length principle.¹⁴⁶ The remuneration of intangible related returns shall be guided by rules on the transfer pricing issues to grant transparent attribution of profits to the business entities.

Identifying the functions that contribute to the DEMPE of intangibles supports the evaluation of MNC group members that are entitled to remuneration.¹⁴⁷ The variety of functions in the DEMPE process is wide; the OECD proposes a right to appropriate compensation for the party effectively controlling outsourced activities, whether by performing them or not.¹⁴⁸ The outsourced activities shall be covered by general applicable rules for the identification of value contributions in the DEMPE processes instead of a list including individual cases. The presumption is, that contractual entitlements and functions are in alignment: the parties claiming contractual entitlement to intangible related returns will have exercise control over the performance of those functions and the associated risks, will bear the necessary costs required to support the performance of the function and will provide arm's length compensation to any associated enterprise physically performing a relevant function.¹⁴⁹ The underlying motivation is, that group members that contribute to the DEMPE process through the use of assets (eg. intangibles used in research, development or marketing (e.g. know-how, customer relationships, etc.), physical assets, or funding) shall get compensation.¹⁵⁰ Reasoned with their obligation of bearing the risks of the

¹⁴⁶ Ortiz Gómez (2019) in Kerschner/Somare, 'Transfer Pricing of Intangibles in the Digital Economy', 290.

¹⁴⁷ Ibid.

¹⁴⁸ Ibid.

¹⁴⁹ Ortiz Gómez (2019) in Kerschner/Somare, 'Transfer Pricing of Intangibles in the Digital Economy', 291; OECD, 'The OECD Discussion Draft on the Transfer of Intangibles (Revision of Chapter VI of the OECD Transfer Pricing Guidelines)', 92, 1.164 – 1.166.

¹⁵⁰ OECD (2015c), 'Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project', 81, 6.59.

contribution, the compensation should be granted fairly and transparent. Relevant risks for DEMPE-transactions are listed in Action 8¹⁵¹ as well as the reference to the risk-analysis.¹⁵²

An activity of high interest is funding. Funding is always connected to particular risk taking. The risk will vary depending on the economically relevant characteristics of the transaction.¹⁵³ The larger the amount of the fund, the larger the risk for the fund provider. The OECD distinguishes between financial risks and economic risks that are linked to the funded operation.¹⁵⁴ In these compositions, only a risk-adjusted return on the funding can be expected.¹⁵⁵ In determining an appropriate return for the funding activities, it is important to consider the financing options realistically available to the party receiving the funds.¹⁵⁶ There might be a difference between the return expected by the funder on an ex ante basis and the actual return received on an ex post basis.¹⁵⁷ The compensation of intangible related returns shall be granted only on a basis reflecting the factual risk taking by the entity claiming the compensation.¹⁵⁸ Such alignment is not existent when there is a mismatch between the contractual allocation of intangible related returns and actual conduct of the associated enterprises.¹⁵⁹

The described analysis of the particular function in the DEMPE process as well as the analysis of the particular risk that is beared by the group member should lead to a clear assessment of ownership, functions, assets and risks that are part of the transaction in question and further to the

¹⁵¹ OECD (2015c), 'Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project', 83, 6.66 ff.

¹⁵² OECD (2015c), 'Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project', 2, 1.60.

¹⁵³ Ortiz Gómez (2019) in Kerschner/Somare, 'Transfer Pricing of Intangibles in the Digital Economy', 291.

¹⁵⁴ OECD (2015c), 'Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project', 81, 6.61.

¹⁵⁵ Ibid.

¹⁵⁶ OECD (2015c), 'Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project', 81, 6.62.

¹⁵⁷ OECD (2015c), 'Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project', 81, 6.62.

¹⁵⁸ Ortiz Gómez (2019) in Kerschner/Somare, 'Transfer Pricing of Intangibles in the Digital Economy', 292.

¹⁵⁹ Ibid.

prices and other conditions that are relevant for the valuation of the intangible and the intangible related returns.¹⁶⁰ The result of the analysis may point at additional or different transactions than described in the MNCs registration and contracts.¹⁶¹ All in all, the result should give a clear overview over the entities that are entitled to returns from intangible exploitation and those who are not. On this base, taxable profits can be attributed to the entities when they have been generated by intangible related returns.

iii. Transactions involving the use or transfer of intangibles

Next to the identification of the MNC members that are entitled to intangible related returns, the OECD acknowledges basically two types of transactions, including the identification and characterization of the transaction types. The different transactions can have impact on the intangibles' value.

There are transfer of intangibles or rights in intangibles and the use of intangibles in connection with the sale of goods or services.¹⁶² While the transfer of the intangible itself or of the entire or limited rights in intangibles is a matter of transfer pricing, the use of intangibles for sale of goods and services and thereby the implementation of contributed value should be taken into account for the transaction volume as well.

The transfer pricing analysis must take account of restrictions that could be imposed in contractual contexts, such as license or other agreements about the use of the intangible. Limitation of further development or of the ability to derive economic benefits can have impact on the value of the transferred rights and the comparability of two transactions involving basically identical or closely comparable intangibles.¹⁶³ Consequently, such contractual limitations need to be imple-

¹⁶⁰ OECD (2015c), 'Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project', 85, 6.73.

¹⁶¹ Ibid.

¹⁶² Ortiz Gómez (2019) in Kerschner/Somare, 'Transfer Pricing of Intangibles in the Digital Economy', 294.

¹⁶³ Ortiz Gómez (2019) in Kerschner/Somare, 'Transfer Pricing of Intangibles in the Digital Economy', 295.

mented in the applicable transfer pricing rules, reflecting the actual habit and conduct of the parties to close this window for BEPS through transfer pricing issues.¹⁶⁴

iv. Implementation of arm's length principle for HTVIs

After completing the transfer pricing analysis, the arm's length principle shall be applied to such transactions, which are guided supportively by BEPS Action 8 Sec. C. The supplemental information to determine arm's length conditions for transactions of intangibles include a comparability analysis considering both parties, resulting in the establishment of a comparable uncontrolled price method or transaction split method as most effective methods due to the missing link between development costs and the final value of the intangible.¹⁶⁵ The new pricing approach on HTVIs aims at the information asymmetry of tax administrations and results in tools to assess transfer prices for HTVI-transactions. Tax administrations do have significant problems to consider the relevant developments for the pricing of the transaction to that extent, that the evaluation is mostly connected to the business environment.¹⁶⁶ Foreseeing relevant contributions requires substantial insights, specialised knowledge and expertise into such environment.¹⁶⁷

It is recommended to consider techniques based on discounted projected cash flows which derive from an intangible, from the determination of appropriate discount rates and from tax effects as external effects and circumstances on the transaction.¹⁶⁸

Further, MNCs may not consider assessments that are only useful for transfer pricing purposes as comprehensive.¹⁶⁹ This is where ex ante and ex post valuation is of designated importance, while

¹⁶⁴ OECD (2015c), 'Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project', 89, 6.91.

¹⁶⁵ Ortiz Gómez (2019) in Kerschner/Somare, 'Transfer Pricing of Intangibles in the Digital Economy', 296.

¹⁶⁶ OECD (2015c), 'Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project', 109, 6.186.

¹⁶⁷ Ibid.

¹⁶⁸ Ortiz Gómez (2019) in Kerschner/Somare, 'Transfer Pricing of Intangibles in the Digital Economy', 298.

it is claimed by the MNC that the ex post value was not predictable even for the MNC. The tax administration cannot prove the MNC wrong due to the information asymmetry and lack of competence in the particular business environment, consequently there is no real arm's length pricing possible.

v. Assessment BEPS Action 8 – 10

The OECD's work on BEPS Action 8 "Intangibles" focuses on the main challenges of transfer pricing issues in transactions involving intangibles and provides steps aiming at those challenges. To safeguard transparent taxation on the profits generated from business models relying on intangibles, there is a need for the identification of the intangible itself and the clarification of ownership. Besides that, the function and qualification of the intangible need to be assessed as well as the assessment of the intangible as an asset and the evaluation of risks that are controlled by the transacting parties. The third point of interest is the transfer of rights in the intangible itself and the anticipated use by the transacting parties.

The definition of intangibles is broader now and subcategories of intangibles such as marketing intangibles, trade intangibles and others are implemented.¹⁷⁰ Furthermore, the OECD underlines the importance of legal ownership when it comes to the exploitation of intangibles and links this to DEMPE-functions that can be contributed to the value creation mechanisms and which shall lead to calculable returns on the contributing MNC-unit.¹⁷¹ Further, the relevant types of transactions are analysed and give supplemental information for the determination of arm's length conditions for such transactions.¹⁷²

¹⁶⁹ Ibid.

¹⁷⁰ Ibid.

¹⁷¹ Ibid.

¹⁷² Ortiz Gómez (2019) in Kerschner/Somare, 'Transfer Pricing of Intangibles in the Digital Economy', 299.

The most challenging aspect of transfer pricing seems to be the overcoming of information asymmetry between taxpayers and tax administrations on the field of HTVIs. The new OECD guidelines are not compatible with arm's length principle since the prediction of value development in these businesses of the transferred intangibles is impossible for at least one party.

All in all, the steps taken by the OECD point in a direction, where the transfer of intangibles is substantially spotted, and guidance is provided for the basic theoretical assessment of this field of challenges. However, the range of problems in the field of base erosion of MNCs through transfer pricing techniques in transactions involving intangibles is not assessed detailed enough in order to provide practical guidance and let tax authorities implement the new rules.¹⁷³

Martin Lagarden who exemplifies some voices from literature, considers that it would be advisable for multinational companies to combine their legal and economic ownership of intangibles at one location or into one company. This can support a more consistent structuring, documentation, and successful argumentation of, for example, contract research set-ups or cross-border licensing of intangibles to affiliated companies in a multinational group versus tax authorities in different countries.¹⁷⁴

c. Minimizing taxable profits by shifting them to low tax jurisdictions

Another tax avoidance strategy in the global economies and in particular in DE is tangent to the field of contractual allocations of profits within MNCs what is also resulting in minimizing taxable profits in high tax jurisdictions. Countries apply different rules on taxation of CFCs and thereby creating tax havens. Action 3 (Strengthening of Controlled Foreign Company (CFC)

¹⁷³ Ibid.

¹⁷⁴ Martin Lagarden, *International Transfer Pricing Journal* (2014) 346; see also: Ortiz Gómez (2019) in Kerschner/Somare, 'Transfer Pricing of Intangibles in the Digital Economy', 299.

Rules) aims at base erosion and profit shifting of parent companies by routing income from high tax jurisdictions to low tax jurisdictions and tries to tackle the incentives to route income to low tax jurisdictions by levelling the global CFC rules and by creating a level playing field.¹⁷⁵

The derived passive income of controlled companies that are established in low tax jurisdictions shall be deemed to be realized by the shareholders of the controlling parent company or shall be deemed to be distributed to them as dividends.¹⁷⁶ Since passive income shall be included as taxable income at the level of the parent company, the benefit from the low tax jurisdiction will disappear.¹⁷⁷

Therefore, the OECD recommends a legal control test (taking into account the voting rights of shareholders) and an economic control test (taking into account the rights on profits, assets, and capital of the company)¹⁷⁸ to determine the degree of control and subsequently to determine the applicability of CFC rules. There is also de facto control and control based on consolidation possible.¹⁷⁹ In many assessments, it is a mixture of the different control types that indicates a certain degree of control being exercised, opening the personal scope of the CFC rules.

Regarding effectiveness, CFC legislation can be based on a global or jurisdictional approach. The global approach applies CFC rules to all CFCs wherever they are resident and regardless of the foreign tax rates. The jurisdictional approach applies CFC rules only to foreign companies' resident in low tax jurisdictions.¹⁸⁰ To cap the costs, the OECD recommends a 'low tax thresh-

¹⁷⁵ Van Hulle (2019) in Kerschner/Somare, 'CFC Rules as a Measure to Address BEPS Opportunities in a Digital Economy', 47.

¹⁷⁶ Van Hulle (2019) in Kerschner/Somare, 'CFC Rules as a Measure to Address BEPS Opportunities in a Digital Economy', 48.

¹⁷⁷ Ibid.

¹⁷⁸ OECD (2015), 'Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 23, 35.

¹⁷⁹ Ibid.

¹⁸⁰ Van Hulle (2019) in Kerschner/Somare, 'CFC Rules as a Measure to Address BEPS Opportunities in a Digital Economy', 51.

old', to consider companies established in jurisdictions below the threshold being not as high at risk to operate base erosion and profit shifting.¹⁸¹

The final requirement for application of CFC rules is about the income and whether portions of the income give rise to BEPS concerns or if the income should be attributed to shareholders directly.¹⁸² The OECD refers to a full inclusion approach (treating all CFC income as attributable income) and partial-inclusion approach (only certain types of income are attributable) without recommending the use of one of the approaches. At least a minimum standard for attributable income should be defined by the OECD to provide guidance through the countless types of movable income and not only by interest, royalties and dividends.¹⁸³

Income that contains BEPS risks needs to be specified by substantive rules, in order to prevent misinterpretations of important value contributing activities as income driver. For instance, DE specific income (that is highly mobile) is generally attributed to shareholders and thus becomes passive income but can be seen as active income as well (depending on the underlying business model, eg. in multi-sided market). The technical equipment of the countries is differing, so an individual assessment of the particular BEPS risks of different income types may still end up in different outcomes, depending on the tax jurisdiction.

To create a level playing field that contains balance between the capital export neutrality, anti-avoidance of tax payments, competitiveness, compliance costs, complexity, and the discrepancy between accepted and non-accepted deferral, the communicated and established rules need to be

¹⁸¹ OECD (2015), 'Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 33, 51.

¹⁸² van Hulle (2019) in Kerschner/Somare, 'CFC Rules as a Measure to Address BEPS Opportunities in a Digital Economy', 51.

¹⁸³ van Hulle (2019) in Kerschner/Somare, 'CFC Rules as a Measure to Address BEPS Opportunities in a Digital Economy', 52.

strengthened by the OECD since tax avoidance through CFCs is a global issue.¹⁸⁴ The only provision of reports is not putting rules into place that might result in incentives for good conduct of companies in terms of taxation.

d. A “New Nexus”: Significant digital presence and virtual establishment

As the analysis of BEPS Action 7 already showed, the amendments do behalf on the application of the physical establishment, what makes it impossible to include business models without any physical establishments.¹⁸⁵ In Action 1, the TFDE already imposes a “new nexus” called *Significant Digital Presence (SDP)*, which shall cover dematerialised business models in an efficient way.¹⁸⁶ There are several options discussed, how the significant digital presence could be designed.

The new nexus shall generally base “on the concept of a significant economic presence”.¹⁸⁷ The presence of a digital business shall be determined by combinations of the factors like revenue and revenue thresholds¹⁸⁸, digital factors such as domain-endings of homepages¹⁸⁹, and user-based factors such as monthly active users (MAUs), online contract conclusions and data collected.¹⁹⁰

¹⁸⁴ van Hulle (2019) in Kerschner/Somare, ‘CFC Rules as a Measure to Address BEPS Opportunities in a Digital Economy’, 52.

¹⁸⁵ See also: V. Bendlinger (2018), *Die Besteuerung der Digital Economy – Eine kritische Würdigung*, JKU Linz Publishing, 34.

¹⁸⁶ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 107ff., 277ff.

¹⁸⁷ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 107, 277.

¹⁸⁸ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 107, 278f.

¹⁸⁹ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 109, 279f.

¹⁹⁰ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 110, 280.

This is criticised from a practical point of view, where some authors are questioning the technical determination of datapoints, concluded contracts or collected data in general.¹⁹¹ It is also unclear how the OECD plans to deal with less regulated virtual spaces like darknet, where increasing transactions are made over the last decade.¹⁹²

Next to the technical problems, it is unclear how the attribution of profits for virtual establishments shall be determined. The existing principles do not fit, so methods based on a fractional apportionment¹⁹³ and modified deemed profit methods¹⁹⁴ are mentioned but not seen as useful.¹⁹⁵

In a more detailed proposal, provided by Hongler and Pistone in 2015, the new nexus is discussed, derived from the source and benefit theory and implementation questions are answered. The conceptual background of the SDP shall reflect the source and the benefit theory, meaning that the tax shall be paid where the profits emerge to pay for the infrastructure that is used by the taxpayer.¹⁹⁶ The design of the new nexus shall be based on the digital presence and needs to be carefully drafted to not appear ring-fencing or to infringe other principles of the international tax law consensus.¹⁹⁷ The design shall be further taking into account, that the use of the infrastruc-

¹⁹¹ Kofler/Mayr/Schlager, 'Digitalisierung und Betriebsstättenkonzept' (2017), RdW 5b/2017/267, 383.

¹⁹² V. Bendlinger (2018), *Die Besteuerung der Digital Economy – Eine kritische Würdigung*, JKU Linz Publishing, 36.

¹⁹³ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 112, 287f.

¹⁹⁴ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 112, 289f.

¹⁹⁵ Kofler/Mayr/Schlager, 'Digitalisierung und Betriebsstättenkonzept' (2017), RdW 5b/2017/267, 383f.

¹⁹⁶ Pistone and Hongler (2015), 'Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy', (IBFD Working Paper, 20 January 2015), 17ff.

¹⁹⁷ Pistone and Hongler (2015), 'Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy', (IBFD Working Paper, 20 January 2015), 23.

ture in a foreign country is reflected by the tax, eg. in form of thresholds that have to be met.¹⁹⁸

They already provided a new paragraph for the OECD-MC, Art. 5 (8) OECD-MC.

*If an enterprise resident in one Contracting State provides access to (or offers) an electronic application, database, online marketplace, 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 services in the other Contracting State exceeds XXX (EUR, USD, GBP, CNY, CHF, etc.) per annum.*¹⁹⁹

According to the wording, the proposal includes a definition of the actual revenue grounds that shall be affected by the new law, defines a threshold on the amount of MAUs, defines a certain timeframe after the user threshold is breached and a certain amount of revenue should be reached to make this rule applicable.²⁰⁰

It should be noted that this proposal contains a minimum threshold instead of four different thresholds on digital sales, number of closed contracts, number of monthly active users and the level of consumption.²⁰¹ The implementation of minimum thresholds would result in a less frag-

¹⁹⁸ Pistone and Hongler (2015), 'Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy', (IBFD Working Paper, 20 January 2015), 24.

¹⁹⁹ Pistone and Hongler (2015), 'Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy', (IBFD Working Paper, 20 January 2015), 25.

²⁰⁰ Ibid.

²⁰¹ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 158.

mented global income of the company and is also excluding some business models from the tax when the taxable activity appears occasional in that market.²⁰²

Another issue of a new nexus would be the avoidance of possible double taxation. That means, that the PE definition based on the digital presence is harmonized and that profit allocation rules are in force to ensure the avoidance of double taxation.²⁰³ Next to that, it must be accounted that not every business in the digitalized environment is positively balanced. Numerous start-ups operating in several jurisdictions are loss-making until they start increasing their values. The proposed new nexus rule should take this into account and avoids significant tax burdens for loss-making companies.²⁰⁴

This can be linked to the question of profit allocation in general. Basically, the attribution of risks and the valuation of the contribution to the value creation mechanism shall be decisive for the profit allocation to a PE or to the SDP. If the SDP is set in force, the profit allocation can be managed in four different ways: contractual attribution, gross income taxation, redefinition of the functions and risks that are relevant for the determination of the appropriate transfer price or a modification of the existing SPM including an allocation of partial profits.²⁰⁵ According to the authors, the first and the third option are unrealistic due to political practicability and the practical problem of attributing functions and risks to the jurisdiction of the PE.²⁰⁶ A modification of the PSM was already thematised by the OECD, a more detailed discussion includes the redefinition of the source of income in the context of digital and mobile income in order to make these

²⁰² Pistone and Hongler (2015), 'Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy', (IBFD Working Paper, 20 January 2015), 26.

²⁰³ Ibid.

²⁰⁴ Pistone and Hongler (2015), 'Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy', (IBFD Working Paper, 20 January 2015), 27.

²⁰⁵ Pistone and Hongler (2015), 'Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy', (IBFD Working Paper, 20 January 2015), 32.

²⁰⁶ Pistone and Hongler (2015), 'Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy', (IBFD Working Paper, 20 January 2015), 32f.

characteristics attributable to a PE based on the digital presence.²⁰⁷ Existing principles taken into account are either an origin-based profit allocation or a destination-based profit allocation. While the origin-based approach would exclude certain levels of the value creation chain on the supply chain as possibly value creating parties, it is the destination-based approach that is unpracticable due to unclear certain values and value contributions. The consequence would be the omission of production factors.²⁰⁸ The only solution for the profit allocation that is in line with economic principles seems to be the allocation of certain percentages of income to market jurisdictions due to the value added in that market jurisdiction, orientating at the amendments on the transfer pricing guidelines of Action 8 BEPS Project.²⁰⁹

e. Digital transaction tax

Another option discussed by the TFDE is a withholding tax for digital transactions.²¹⁰ In order to cover a wide range of transactions without treating similar transactions differently depending on their form, the OECD aims at a general and flexible definition of transactions and payments including non-residents.²¹¹ From a practical point of view, the payment from the non-resident enterprise is often shifted to a local collecting agent. The payment of the withholding tax shall be governed by the payment agent, in B2B transactions by the source country resident.²¹² In cases of B2C transactions, the collection of WHT might lead to problems due to the little experience of

²⁰⁷ Pistone and Hongler (2015), 'Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy', (IBFD Working Paper, 20 January 2015), 33.

²⁰⁸ Ibid.

²⁰⁹ Pistone and Hongler (2015), 'Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy', (IBFD Working Paper, 20 January 2015), 34.

²¹⁰ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 113ff., 292ff.

²¹¹ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 113, 294.

²¹² OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 114, 295, 296.

customers and the missing incentives to declare the tax and in respect of the large numbers of transactions, each with small amounts, what would raise administrative challenges.²¹³

It is discussed, that a possible solution requires intermediaries processing the payment in B2C contexts, but still suffers from technical problems due to lacks of information about the transaction itself and thereby the identification of the payable tax amount is not possible.²¹⁴ The task of the intermediary could be supported by mandatory registration for non-resident enterprises, opening the field to subsequent problems such as transactions that are only possible to registered intermediaries and for only several transaction types.²¹⁵ All in all, a WHT on digital transactions imposes practical challenges on intermediaries situated in third-countries and thereby create new opportunities for tax avoidance strategies, a solution is not reached.²¹⁶

f. Equalisation levy

The last option that is discussed by the OECD in Action 1 is the “equalisation levy”. It shall ensure equal treatment of foreign domestic suppliers by imposing taxes intending to address disparities between domestic and foreign corporations in the same tax system.²¹⁷ The scope of the levy should take into account, that transactions concluded remotely with in-country customers on the one hand and businesses interacting with customers via online presence on the other hand are the two categories that can be addressed by such an equalisation.²¹⁸ Alternatively, the scope could be limited to transactions involving the conclusion of contracts on goods or services through auto-

²¹³ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 114, 295.

²¹⁴ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 114, 297.

²¹⁵ Ibid.

²¹⁶ Ibid.

²¹⁷ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 115, 302.

²¹⁸ OECD (2015a), ‘Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project’, 116, 303.

mated systems between two or more parties effectuated through a digital platform.²¹⁹ This would create incentive to not fully include the impact of the digital circumstances of the transaction in order to bypass the payment obligation. As the OECD already points out, narrowing the scope on types of transactions leads to counterproductivity in terms of flexibility and ultimate effectiveness when trying to tackle tax disparity.²²⁰

Practically, the levy would be paid by in-country customers and would be collected by the foreign enterprises or local intermediary via a registration system. The administrative effort seems to be immense, the incentive for the customers to finally declare the tax is unclear.

Another practical problem could arise on European Union (EU) level, when only non-resident enterprises would be subject to the levy.²²¹ All possible solutions that should lead to equal treatment between foreign and domestic entities need presumable considerations on the impact of the applicable corporate income tax (CIT) and the levy and finally about the relationship of those two.²²² As possible solution, the OECD discusses a crediting method of CIT and equalisation levy, allowing the tax subject to credit the levy against the domestic CIT.²²³ The benefit of this solution would be, that even companies with no nexus in the market jurisdiction can be taxed, but only to the levy in the source country, meaning the corporate tax is limited to the higher burden of either CIT or levy, creating at least a situation that is comparable to a level playing field.²²⁴

²¹⁹ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 116, 304.

²²⁰ Ibid.

²²¹ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 116, 306.

²²² OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 117, 306f.

²²³ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 117, 308.

²²⁴ OECD (2015a), 'Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project', 117, 308.

5. EU proposals for a fair taxation of digital economy

Parallel to the development on OECD level, the EU started facing the taxation of DE and drafted two proposals for directives in May 2018.²²⁵ The proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence (COM(2018) 147 final, “SDP-Dir.”) has to be discussed in the light of the nexus debate on the OECD level, while the proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services (COM(2018) 148 final, “DST-Dir.”) is aiming at taxation of transactions in the DE.

As stated in EUCO 14/17, the council has recognised the need “to ensure that all companies pay their fair share of taxes and to ensure global level-playing field in line with the work currently underway at the OECD”.²²⁶ The member states stand united behind the goal, that all companies shall pay “their fair share of taxes”, which, in turn, raises the question whether this is not the case at the present. The effective corporate tax rates show that there is no significant difference between traditional and “digital” companies to be seen.²²⁷ Scholars show, that the popular picture of effective corporate tax rate of DE companies under 10% is reasoned in the miscalculation combined with the focus on the 5 IT giants performed by the Commission.²²⁸ As already shown above, it is not even possible to differentiate between digital economy and digitalized economy, since the value creation of traditional and new business models evolves. The EU acknowledges that the existing weaknesses of international taxation is not reasoned in DE itself but exacerbated

²²⁵ European Commission, ‘Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence’, 21.03.2020, COM(2018) 147 final; European Commission, ‘Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services’, 21.03.2020, COM(2018), 148 final.

²²⁶ EUCO 14/17 – 19. October 2017, 8

²²⁷ Bauer (2018), ‘Digital Companies and Their Fair Share of Taxes: Myths and Misconceptions’, 10.

²²⁸ Bauer (2018), ‘Digital Companies and Their Fair Share of Taxes: Myths and Misconceptions’, 15.

by the increasing amount of possible transactions in DE.²²⁹ A final differentiation cannot be made on a EU level at this point. However, the EU needed to take the opportunity to have impact on the global discussion in order to safeguard that this important business sector is still competitive and able to scale up in the same tempo as in other markets in the world.²³⁰

Aiming at nexus issues of the DE, the EU proposed a draft directive implementing the significant digital presence theory.²³¹

a. Significant Digital Presence

The significant digital presence should serve as long-term solution for member states and shall take into account the global comparability of tax systems.²³² The SDP-Dir. was based on Art. 115 TFEU which is designed to overcome specific market obstacles and to harmonise the European internal market.²³³ To capture the DE in the jurisdictions where profits are generated, the directive needs to meet the requirements of a unilateral legal system complying with the principle of subsidiarity.²³⁴ The Commission also underlines the efforts to bring the SDP-Dir. in line with the Common Consolidated Corporate Tax Base (CCCTB)²³⁵, focusing on the unified profit allocation of SDP.²³⁶

²²⁹ V. Bendlinger (2018), *Die Besteuerung der Digital Economy – Eine kritische Würdigung*, JKU Linz Publishing, 28.

²³⁰ European Commission, ‘A Fair and Efficient Tax System in the European Union for the Digital Single Market’, 21.09.2017, COM(2017) 547 final.

²³¹ European Commission, ‘Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence’, 21.03.2020, COM(2018) 147 final.

²³² European Commission, ‘Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence’, 21.03.2020, COM(2018) 147 final, 3.

²³³ Leidenmühler in Jaeger/Stöger EUV/AEUV, Art 115 AEUV, 2.

²³⁴ European Commission, ‘Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence’, 21.03.2020, COM(2018) 147 final, 5.

²³⁵ European Commission, ‘Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence’, 21.03.2020, COM(2018) 147 final, 4.

²³⁶ V. Bendlinger (2018), *Die Besteuerung der Digital Economy – Eine kritische Würdigung*, JKU Linz Publishing, 42.

i. Significant digital presence as Nexus

The SDP-Directive is basically widening the term of the permanent establishment, Art. 1 SDP-Dir. Since the basic connection for taxation is seen in establishment, the permanent establishment needs to be set up in a digital environment.

The idea is to establish a taxable nexus of a DE actor in a MS and to base this nexus on a so-called “digital footprint”, constructed out of revenues from digital services, MAUs or the number of closed contracts from digital services.²³⁷ This shall also reflect the impact of user contribution to the value creation mechanism and consider different types of business models.²³⁸

The central legal definition of the SDP can be found in Art. 4 (3) SDP-Dir., where a “SDP shall be considered to exist in a MS in a tax period if the business carried on through it consists wholly or partly from the supply of digital services through a digital interface and one or more of the following conditions is met [...]”. Therefore, it is necessary to define the term “digital interface”, through which the business is wholly or partly carried on. The definition could be found in Art. 3 (2) SDP-Dir., stating such interface as “any software, including a website or a part thereof and applications, including mobile applications, accessible by users [...]”. Next to “interface”, there must be a definition for “digital services” or at least some points of reference. According to Art. 3 (5) SDP-Dir., digital services generally means “services which are delivered over the internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology [...]”, additionally providing a list of various elements: supply of digitised products (lit. (a)), services providing or supporting a business or personal presence on an electronic net-

²³⁷ European Commission, ‘Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence’, 21.03.2020, COM(2018) 147 final, 7.

²³⁸ Ibid.

work such as a website or a webpage (lit. (b)), services automatically generated from a computer via the internet or an electronic network, in response to specific data input by the recipient (lit. (c)), services linked to online marketplaces (lit. (d)), provision of Internet Service Packages (ISP) with central telecommunication components (lit. (e)) and a subsequent list of activities in Annex II (lit. (f)). Although a number of business practices are mentioned here, the Commission's more detailed explanation should be consulted when it comes to the correct classification of business models in question as a digital service. For example, the placement of buyers and sellers in an online marketplace is a digital service, but not the purchase or sale.²³⁹

In addition, quantitative thresholds for the existence of a significant digital presence are laid down in Art. 4 (3) SDP-Dir. They do not have to be met cumulative to point out the particular significance of the digital presence. Significant digital presence shall be qualified, if the proportion of total revenues obtained and revenues resulting from the supply of digital services to users located in that MS in the same tax period exceed EUR 7000000 (lit. (a)), if the number of users of one or more of those digital services who are located in that Member State in that tax period exceeds 100 000 (lit. (b)) or if the number of business contracts for the supply of any such digital service that are concluded in that tax period by users located in that MS exceeds 3 000 (lit. (c)). This shall reflect the costs for tax and legal advice should not exceed the costs of the specific digital establishment to tax real profits instead of losses, but it is at least questionable if this covers all real costs in the end.²⁴⁰

According to the SDP, the central link for the profit attribution shall be the user who needs to be assigned to a member state, Art. 4 (3) lit. (a) SDP-Dir. The location of the user is defined in Art. 4 (6) SDP-Dir., the most frequently used technique might be the processing of IP-address infor-

²³⁹ S. Bendlinger (2018), '(Non-)Sense of the digital permanent establishment: Package of EU Directives on taxation of the digital economy', SWI 2018, 268 (271).

²⁴⁰ V. Bendlinger (2018), *Die Besteuerung der Digital Economy – Eine kritische Würdigung*, JKU Linz Publishing, 44.

mation of the user's device.²⁴¹ Regarding Art. 4 (3) lit. (c) SDP-Dir., contracting through digital services, the user shall be assigned to that member state, where he is located for CIT purposes or running a PE.²⁴²

ii. Profit allocation under the SDP-Directive

After defining SDP, the allocation of profits can be discussed. Art. 5 SDP-Dir. considers profit allocation rules that are reminiscent of the OECD-rules on transfer pricing in terms of remaining applicability and point out the close cooperation between EU and international partners when addressing the challenges of taxation of profits of DE.²⁴³

To allocate profits to a SDP, the economically significant activities performed via the digital interface shall be decisive.²⁴⁴ "Economically significant" is every contribution to the value creation mechanism (DEMPE) of the enterprise's intangible assets through data and users input, Art. 5 (4) SDP-Dir. Economically significant activities are listed in Art. 5 (5) SDP-Dir., such as the collection, storage, processing, analysis, deployment and sale of user-level data (lit. (a)), the collection, storage, processing and display of user-generated content (lit. (b)), the sale of online advertising space (lit. (c)), the making available of third-party created content on a digital marketplace (lit. (d)) and the supply of any digital service not listed in points (a) to (d) (lit. (e)).

²⁴¹ S. Bendlinger (2018), '(Non-)Sense of the digital permanent establishment: Package of EU Directives on taxation of the digital economy', SWI 2018, 268 (272).

²⁴² Ibid.

²⁴³ European Commission, 'Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence', 21.03.2020, COM(2018) 147 final, 11.

²⁴⁴ V. Bendlinger (2018), *Die Besteuerung der Digital Economy – Eine kritische Würdigung*, JKU Linz Publishing, 46.

One approach is seen in the implementation of the “economically significant activities”, that are pointed out in Art. 5 SDP-Dir. and added by an exemplary list of possible activities.²⁴⁵ Nevertheless, regarding the supplemental argumentation of the EU this approach is not solving the profit allocation in this context.²⁴⁶

Alternatively, Art. 5 (1) SDP-Dir. reflects tax frameworks in the source countries and thereby profit allocation rules like profit split method (PSM) or more appropriate methods, if the additional value of such an alternative method is proven by the tax subject.²⁴⁷

Art. 5 (2) SDP-Dir. defines the “separate entity approach”, meaning that “profits attributable to or in respect of the significant digital presence shall be those that the digital presence would have earned if it had been a separate and independent enterprise performing the same or similar activities [...]”. At the same time, the Commission acknowledges the “Authorised OECD Approach” and recognizes, that a conventional functional analysis needs to be adjusted to the particularities of DE businesses (eg. regarding personnel, property and riskfactors).²⁴⁸

The profit allocation via PSM is seen as primarily applicable, because it is based on factors that include R&D expenses, MAUs and datasets. PSM could be substituted by a more appropriate method based on international standards, if the appropriation of such an alternative is proven.²⁴⁹

All in all, the Commission did not manage to provide a sufficient solution on the profit allocation issue. The discussion of the economically significant activities, that shall imply the contribution

²⁴⁵ European Commission, ‘Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence’, 21.03.2020, COM(2018) 147 final, 11.

²⁴⁶ V. Bendlinger (2018), *Die Besteuerung der Digital Economy – Eine kritische Würdigung*, JKU Linz Publishing, 46.

²⁴⁷ European Commission, ‘Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence’, 21.03.2020, COM(2018) 147 final, 11f.

²⁴⁸ V. Bendlinger (2018), *Die Besteuerung der Digital Economy – Eine kritische Würdigung*, JKU Linz Publishing, 46.

²⁴⁹ V. Bendlinger (2018), *Die Besteuerung der Digital Economy – Eine kritische Würdigung*, JKU Linz Publishing, 46.

to the value creation mechanisms and the DEMPE-process was a first intention to create a new key element for the attribution rules. Without providing final guidance on this matter, the profit allocation under the SDP-Dir. is not solved and will be the deal breaker for the implementation on a EU level.

iii. Assessment Significant Digital Presence and the SDP-Directive

The SDP-Directive was promising, it was a step facing the nexus issues of DE and, not to be neglected, a first mover. The directive is formulated that the scope is wide and various different business models can be qualified as subject under this directive. The communication about the digital presence and its significance is clear and transparent. Communication problems are spotted on the turnover thresholds, which appear arbitrary.

The problem is still seen in the profit allocation. The basic idea of creating a one-stop-shop in a MS is good and should result in lean administrative processes. Art. 5 SDP-Dir. states several acknowledgements on different value creation mechanisms but is not providing a final solution to the profit allocation problem. An implementation needs such practical tools to be effective and to provide legal certainty and guidance for the MS and the companies.

The SDP-Directive can serve as blueprint for upcoming laws and offers a basis for further developments on the matter in an international field. The concept of modifying the PE in form of a significant digital establishment is the promising way for future developments, when a sufficient solution for the profit allocation can be found.²⁵⁰

²⁵⁰ V. Bendlinger (2018), *Die Besteuerung der Digital Economy – Eine kritische Würdigung*, JKU Linz Publishing, 76; see also: Eilers/Oppel, *Die Besteuerung der digitalen Wirtschaft: Trends und Diskussionen – Überblick über die Arbeiten der OECD und EU mit kritischer Einordnung*, iStR 2018, 361 (370).

b. Digital Service Tax

Next to the SDP, the Commission proposed an alternative proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services (digital service tax (DST)). It should implement a withholding tax on online transactions in the EU. This alternative was not meant to be the preferred approach but as “back up” or “quick fix”²⁵¹ to be implemented in the member states, while the SDP-approach would require global unity to reach the aims of addressing international taxation challenges in DE.

The scope of transactions in the DST is set out in Art. 3 (1) lit. (a) – (c) DST-Dir., the placing of targeted advertising on a digital interface (lit. (a)); making multi-sided digital interfaces available to users which allows users to find other users and to interact with them, and which may also facilitate the provision of underlying supplies of goods or services directly between users (lit. (b)); and the transmission of data collected about users and generated from users' activities on digital interfaces (lit. (c)) shall qualify as taxable business activities.

As the Commission states in the recital of the DST-Dir., “only certain entities should qualify as taxable persons for the purposes of DST, regardless of whether they are established in a Member State or in a non-Union jurisdiction. In particular, an entity should qualify as a taxable person only if it meets both of the following conditions: (i) the total amount of worldwide revenues reported by the entity for the latest complete financial year for which a financial statement is available exceeds EUR 750 000 000; and (ii) the total amount of taxable revenues obtained by the entity within the Union during that financial year exceeds EUR 50 000 000.”²⁵² The thresholds should limit the application of DST to the companies that are mainly able to provide those digital services for which user contribution plays a fundamental role, and which heavily rely on exten-

²⁵¹ S. Bendlinger (2018), ‘(Non-)Sense of the digital permanent establishment: Package of EU Directives on taxation of the digital economy’, SWI 2018, 268 (274).

²⁵² European Commission, ‘Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services’, 21.03.2020, COM(2018), 148 final, 19.

sive user networks, large user traffic, the exploitation of a strong market position and where the risk of aggressive tax planning is consequently higher.²⁵³ The exclusion of smaller companies and start-ups is made with an eye on the additional costs for the smaller companies to administer the tax burden and thereby causing a disproportionate effect.²⁵⁴ The second threshold should limit the application to cases where there is a significance given for the digital footprint in the EU in relation to the covered types of revenues.²⁵⁵

According to Art. 5 (1) DST-Dir., “taxable revenues obtained by an entity in a tax period shall be treated for the purposes of this Directive as obtained in a Member State in that tax period if users with respect to the taxable service are located in that Member State in that tax period.” And further according to Art. 5 (2) DST-Dir., “in the case of a service falling within Art. 3 (1) lit. (a) [targeted advertising], the advertising in question appears on the user's device at a time when the device is being used in that Member State in that tax period to access a digital interface.” Services falling within Art. 3 (1) lit. (b) DST-Dir. shall locate the user in a MS according to the accessed digital interface, Art. 5 (1) lit. (b) DST-Dir. Profits shall be allocated by distribution key elements depending on the origin of the profits (online advertisement, agent services ao.), Art. 5 (3) DST-Dir. The place where the factual transaction takes place is irrelevant, Art. 5 (4) DST-Dir., it is only of interest where the user accessed the questionable transaction, an information accessed by geolocation via IP-address-analysis.²⁵⁶ It is further irrelevant whether the users have

²⁵³ European Commission, ‘Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services’, 21.03.2020, COM(2018), 148 final, 19.

²⁵⁴ European Commission, ‘Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services’, 21.03.2020, COM(2018), 148 final, 20.

²⁵⁵ Ibid.

²⁵⁶ S. Bendlinger (2018), ‘(Non-)Sense of the digital permanent establishment: Package of EU Directives on taxation of the digital economy’, SWI 2018, 268 (276).

contributed in monetary terms to the generation of income, nor if the payment or the placing of the order is made via a digital interface.²⁵⁷

According to Art. 9 DST-Dir. the tax is to be paid by the company or entity that has provided the taxable services. Art. 10 DST-Dir. gives a precise insight in the practical side of declaration of the DST. The taxable person needs to register within 30 days in one MS and this MS is acting as a one-stop-shop from this moment on, collecting and exchanging all relevant information about the taxable person with other MS and to allocate the taxes between each other.²⁵⁸ The declaration has to be made within 30 days after ending of the relevant period of time, Art. 14 DST-Dir., and needs to fulfil the requirements of Art. 15 DST-Dir. In other words: The tax needs to be declared in only one MS (one-stop-shop principle) but is owed to all MS.²⁵⁹ Art. 18 (4) DST-Dir. enables MS to enforce the DST payment as well as control measures and audits.

The taxable base and the tax rate are coordinated in Art. 7 ff. DST-Dir. It should be a yearly tax with a rate of 3 % (Art. 8 DST-Dir.) on all taxable profits (Art. 3 (1) lit. (a) – (c) DST-Dir.) that are generated within the tax period minus WHT or similar indirect taxes.

c. The failure of the DST

The Commission's proposals were highly criticised and in the end not successful at all. The main argument is, that it needs a global approach to tax economic effects of globalisation instead of a solution on a EU level.²⁶⁰ The proposals of the EU Commission reflect a traceable step to

²⁵⁷ Ibid., European Commission, 'Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services', 21.03.2020, COM(2018), 148 final, 33.

²⁵⁸ S. Bendlinger (2018), '(Non-)Sense of the digital permanent establishment: Package of EU Directives on taxation of the digital economy', SWI 2018, 268 (276).

²⁵⁹ S. Bendlinger (2018), '(Non-)Sense of the digital permanent establishment: Package of EU Directives on taxation of the digital economy', SWI 2018, 268 (276).

²⁶⁰ S. Bendlinger (2018), '(Non-)Sense of the digital permanent establishment: Package of EU Directives on taxation of the digital economy', SWI 2018, 268 (277).

get into a pole position in the international discussions about possible solutions for the problem of taxation of DE.

The arguments against an implementation of a DST were brought down on 5 different points by the Scientific Advisory Board for the Federal Ministry of Finance Germany.²⁶¹ The DST is named to be an “indirect tax”, what means it shall tax the recipient of a service in form of a consumption tax. As seen in the DST-Dir., the DST shall tax company revenues what makes it a “direct tax”, taxing revenues that are already subject to CITs in source countries. The second argument against a DST is possible double taxation. International tax law allocates the taxation right to the country where the company is situated. A DST would exist next to the established international system and would tax the same income in multiple countries. It is not clear for the Scientific Advisory Board, why the DST offers an unequal solution to a global problem, which also manifests in the turnover thresholds of Recital 19. The Board is also raising concerns about the competence of the EU to implement such taxes, as long as Art. 113 TFEU is merely not applicable to a matter like the DST as direct tax. The third argument is about economic side effects and costs; the side effects cannot be unseen for the EU. MNCs will react on additional taxes with lower investments and resettlements to more attractive tax destinations. Reactions are to be feared in international trade wars, when other economic superpowers are applying the idea of taxing foreign companies on the basis of their domestic revenues on traditional industries like car industry. The effects of the ring-fencing and distortive design can be multi-layered and are only manageable under enormous financial efforts. The costs of such tax systems might be enormous, the whole administration needs to be covered by the tax income and by calculating with the given 3 % on a market as big as the German market for online advertisement, the tax income is about EUR 195 Million. The fourth argument is the breach of international tax law order by the

²⁶¹ Scientific Advisory Board of the Federal Ministry of Finance Germany: Opinion on the EU proposals for taxation of the digital economy, September 2018.

implementation of a DST in the EU MS. The status quo is the right to tax company profits for the country where this company is established and that profits are taxed and not revenues. The DST would result in the opposite. The last argument is about the legal agility and the idea of the “quick fix”. Changes of Directives require unanimity. Amendments in form of implementing new (technical) insights cannot be made, because the requirement of unanimity for changes of the law slow down the whole process for reactions on the matter and lower the chances of replacing the DST by a “new PE tax” in the future. The “quick fix” could last for decades, in the light of the strong arguments listed above this is not what the EU needs to come over the taxation problem of DE.

These arguments were shared between MS, the clear advice of the board was to not support the implementation of the proposal of the DST-Directive. In the end, the DST was not successful.

d. Verification of the underlying assumptions

The EU’s intention to “gain momentum on the policy debate”²⁶² is fairly understandable in the light of increasing individual national approaches aiming at the same thing: taxation of profits from the digital economy. But the arguments of different ministerial advisory boards in the MS raise questions about the background thoughts of the EU while proposing the two directives. The thoughts and political goals are documented online.²⁶³ Central motivation is the misalignment between taxation and place of value creation, followed by general presumptions that need to be assessed in terms of factual correctness.

²⁶² Olbert, Spengel, *Taxation in the Digital Economy – Recent Policy Developments and the Question of Value Creation*, ZEW Publishing (2019), No. 19-010, 11.

²⁶³ <https://ec.europa.eu/taxation_customs/business/company-tax/fair-taxation-digital-economy_en> accessed 11 June 2020.

i. Corporate tax rules are outdated

Existing rules are based on a time where CIT was not part of society and the effects of digitalisation were not even foreseeable if even existent. The idea to re-think and renew the current tax system might be right, even when there is no proof for a necessity.

ii. Digital businesses undertaxed

The public communication on this topic is “companies with digital business models pay less than half the tax rate of businesses with traditional business models”.²⁶⁴ Studies show, when the average effective tax rates (AETRs) and the cost of capital for stylized marginal and profitable corporate investments in typical assets of digital business models are compared, that investments in digital business models face lower AETRs and capital costs since more favourable depreciation rates typically apply to software and information technologies compared to traditional businesses, and that the benefit from special incentives such as R&D and IP Box regimes is higher in digital business models.²⁶⁵ There is no empirical proof, that digital businesses pay systematically less taxes, the figures are relating to investments of digital businesses that have effects on the tax.²⁶⁶

²⁶⁴ Olbert, Spengel, *Taxation in the Digital Economy – Recent Policy Developments and the Question of Value Creation*, ZEW Publishing (2019), No. 19-010, 12; <https://ec.europa.eu/taxation_customs/business/company-tax/fair-taxation-digital-economy_en> accessed 11 June 2020.

²⁶⁵ Olbert, Spengel, *Taxation in the Digital Economy – Recent Policy Developments and the Question of Value Creation*, ZEW Publishing (2019), No. 19-010, 12.

²⁶⁶ Olbert, Spengel, *Taxation in the Digital Economy – Recent Policy Developments and the Question of Value Creation*, ZEW Publishing (2019), No. 19-010, 12; Bauer (2018), ‘Digital Companies and Their Fair Share of Taxes: Myths and Misconceptions’.

iii. A pre-specified amount of revenue, number of customers, and number of concluded contracts are valid criteria to determine a SDP

It is not clearly argued, why thresholds like the turnover in Recital 19 of DST-Dir. have to be followed by particular consequences. The thresholds appear arbitrary and not valid to be used as justifications for the purpose of the rules.²⁶⁷ The SDP-Dir. is even harder to quantify with thresholds, as the executions about HTVIs and particularities of digital business models in general have shown.²⁶⁸

iv. The Digital Service Tax applies where the largest gap between value creation and the ability to tax exists

The DST shall “focus on activities where there is a large gap between the value created and member states’ ability to tax it – where user participation and user contribution play a central role in value creation.”²⁶⁹ The EU is not providing explanations on the “gap between value creation and ability to tax it”. The definitions given by the DST-Dir. exclude several business models from the scope of DST that are based on user contribution and participation. Distinguishing between different business models within the digital economy by definitions is ring-fencing within the DE itself and ring-fences the DE compared to other industries. It is at least questionable, if the design of the DST is useful for overcoming the “gap”.²⁷⁰

²⁶⁷ Olbert, Spengel, *Taxation in the Digital Economy – Recent Policy Developments and the Question of Value Creation*, ZEW Publishing (2019), No. 19-010, 13.

²⁶⁸ 2.a, p. 4 ff. and 2.b, p. 7 ff.

²⁶⁹ <https://ec.europa.eu/taxation_customs/business/company-tax/fair-taxation-digital-economy_en> accessed 11 June 2020.

²⁷⁰ Olbert, Spengel, *Taxation in the Digital Economy – Recent Policy Developments and the Question of Value Creation*, ZEW Publishing (2019), No. 19-010, 14.

v. It is possible to distinguish between business models for which Digital Service Tax applies

This is strongly connected with the 4th presumption of the EC.²⁷¹ DST implies a possible distinction between revenues that fall under the scope and those that are not subject to DST-Dir. In practice, companies with worldwide total turnover of EUR 750 Million and more use often more than one business model and the allocation of profits to the business models is a demanding and sometimes impossible act that would cause costs on monetary and time level.²⁷² As Olbert and Spengel state, “competitors will need to carefully evaluate to what extent the DST could be levied on their services revenue. Even abstracting from the fact that the portfolio of services and the revenue mix of those companies will be rapidly changing in the future, the administrative burden and legal uncertainty will be immense for both taxpayers and authorities.”

vi. DST and SDP are necessary for a European solution

The last presumption that guides the EU proposals on DST and SDP is the necessity for the European solution. The outcomes in form of the proposals is proven ring-fencing and will lead to economic side-effects like double taxation, legal uncertainty and increasing effective tax burdens for companies.²⁷³ When arguing on potential European solutions, it should be taken into account whether the financial contribution to the fiscal balances in each MS is high enough to cover the costs and risks. “Policymakers should carefully evaluate whether this figure has the potential to generate fairness and efficiency in the EU tax systems, protect the integrity and a proper functioning of the single market [...]“, as Olbert and Spengel pointed out.²⁷⁴ In the light of the given

²⁷¹ Ibid.

²⁷² Ibid.

²⁷³ Olbert, Spengel, *Taxation in the Digital Economy – Recent Policy Developments and the Question of Value Creation*, ZEW Publishing (2019), No. 19-010, 15.

²⁷⁴ Ibid.

presumptions, the verification of the guiding thoughts leads to one final consequence: The EU should focus on developing a comprehensive solution and contribute to an international solution in the way the OECD already has proven as promising when it comes to the BEPS project.²⁷⁵

6. Final assessment and outlook

The aim of this work was to show the impact of the particularities of the digital economy on the discussion on international tax law. This aim should have been reached by answering the question, if ‘the common taxation procedures and approaches meeting the requirements of a digitalized and globalized world or is there a need for fundamental renewals and if so, which measures could be seen as appropriate?’ and pointing out the particularities of the digital economy that has to be taken into account by the policymakers when trying to set up rules resulting in a fair and efficient taxation.

The discussion of the different business models that are popular in the digital economy pointed out that there are several challenges for the tax authorities in order to prevent tax avoidance. The strategies of tax avoidance in the DE are depending on the use of the particular business model. As shown, it can be distinguished between four main tax avoidance strategies that are used by the companies: Avoiding of a taxable presence, minimizing the taxable income, maximising deductions and the utilization of treaty shopping scenarios.²⁷⁶ This work identifies the Nexus debate, the question about how to deal with data and in the characterisation of value creators as main challenges for the policymakers.

The OECD’s work on the BEPS project, starting with Action 1 and the focus on the digital economy, can be seen as the fundamental steps to explain the particularities of digital businesses and to identify relevant areas for taxation. Action 1 is not providing any detailed or fundamental

²⁷⁵ Ibid.

²⁷⁶ p. 14 ff.

rules to overcome the problems and challenges mentioned, but the references to other BEPS Actions are helpful. The discussion of approaches like equalization levy, digital transaction tax and significant digital presence was made in Action 1 without providing any final result on equalization levy and digital transaction tax.

In the international context, the significant digital presence might be the concept that will be the most promising in the future. The OECD's work on the digital presence serves as good basis for the wide range of challenges in DE taxation, while Action 7 only focusses on several business models but not the DE in general. The tool of significant digital presence is not formulated detailed enough by the OECD, the problem of profit allocation is still not solved. It can be expected with tension, which solution the OECD will present on this matter in future.

Regarding the economic resources in DE businesses, it is clear that the treatment of intangibles for economic reasons has to be discussed and new rules need to be established in order to result in a good practice catalogue for companies dealing with intangibles. The OECD spotted transfer pricing issues as the key activity performed by businesses relying on intangibles and data. The proposed amendments are well structured and former unclear terms are defined. The only potential that has not been fully exploited is the provision of clear and structured practical implementation guidance for authorities and taxpayers. It seems unclear how to overcome the information asymmetry on valuing the intangibles without offending existing principles and rules.

Furthermore, this work contains a discussion of BEPS Action 3 as the applicable Report for new rules aiming at treaty shopping of companies. The discussion of MNCs and their opportunities to shift turnovers to low tax jurisdictions is important. But it needs more to implement incentives for good conduct of companies than the only detection of tax avoidance strategies. As seen, the potentials in the context of forum shopping have not been exploited by the OECD yet.

In the light of unilateral measures taken by governments all over the world and in particular within the EU, the EU Commission drafted two proposals that concentrate on two concepts. The first one was about the significant digital presence, the second one was about a digital service tax. The proposals were not successful at all. The arguments and considerations of the MS against the digital service tax were immense and manifold. Important for the unsuccessful proposal are the underlying assumptions for such tax system. The DST should have resulted in fair and competitive markets within the EU, but the analysis of the DST showed, that it could not have resulted in a fair and effective taxation. The main argument against a DST is set on a practical side when implementation and profit allocation lack of practical certainty. Additionally, it was problematically that the DST was not taking further tax burdens into account and did not credit these burdens. Furthermore, there are no sufficient solutions for scenarios where companies generate losses provided. A fair and efficient solution requires answers and guidance for these topics, a sufficient solution is not reached at all.

To sum up, the digital establishment and the significant digital presence are the concepts that are most promising for taking all mentioned requirements into account. Neither the discussion in Action 1 nor the draft proposal of the EU serves as blueprint, but the underlying idea seems to be appropriate and seems to have the potential to finally result in a global tax system providing a fair and effective profit allocation and thereby in a practicable solution. This would still require a global support by different governments, it is at least questionable if consensus can be reached in times of trade wars and global crisis.

The digital establishment is not flexible enough yet. The requirements are mostly connected to thresholds that appear arbitrary and that are not well argued by the authorities and therefore not transparent enough to serve as a blueprint.

All in all, the final result of work is that there is no solution reached by now. Neither the OECD nor the EU have managed to provide sufficient solution approaches by now. In the light of the academic hypothesis, the amendments made in the BEPS project are pointing in the right direction but do not sufficiently provide answers to the manifold problems that occur in the digitalized world.

The TFDE announced a new report or 2020, but in the light of the current crisis shaking the global economy, it is at least questionable if a final solution will be provided in this year. As long as there is no global agreement on the taxation of DE, more unilateral measures will be taken in form of equalization levies and other concepts will be implemented. Fair taxation is only reached when global consensus is reached. Increasing amounts of unilateral measures will counteract the idea of avoiding double taxation. The more unilateral measures appear, the less the governments' willingness to agree on a global taxation system that might result in lower tax income and in lower investments for the single state. The situation as a whole has got immense potentials but is still not solved in all details. The challenges for international policymakers will be great and can be identified as one of the biggest projects in international tax law for these times.

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