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## **THE IMPORTANCE OF PERMANENT ESTABLISHMENT IN THE CONTEXT OF TAXATION ISSUES IN E-COMMERCE**

*E-commerce (including e-service) is considered a business method that eliminates territorial boundaries and provides new opportunities to businesses. Notwithstanding the advantages of e-commerce, it also brings some challenges, including in tax matters. For countries, taxation right for e-commerce activities is mainly based on the location of such activities performed. Although issues and disadvantages have always occurred in international practice, currently they are increasing quickly. Countries are concerned with the taxation of e-commerce, that they might not gain their fair share of tax from the taxation process, meanwhile realizing that there should be chosen such a mechanism of taxation so that it would not hinder conducting such transactions.*

*Hence, within the framework of e-commerce, for determining the taxation location of the profit, defining a permanent establishment has a significant role, because it is considered the main tool for having the right to tax a non-resident entity. It is obvious, that for regulating the taxation of e-commerce, international cooperation is needed, but such cooperation is not easy, because of the conflicting interests of different countries.*

*According to the Organisation for Economic Cooperation and Development (OECD) leading model, the competence of taxing business income is given to that contracting country, where a permanent establishment of a transaction party exists.*

**Keywords:** *e-commerce, fixed place, internet, permanent establishment, profit, server*

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**Introduction.** International transactions are starting to be more widespread and acceptable for many countries. Transactions through the internet are more preferable for companies.

E-commerce providers sell goods or services to buyers directly through websites, social platforms, or other applications. But, notwithstanding the advantages that e-commerce creates, it also results in some difficulties, connected with the uncertainties of tax legislations of the contracting parties of a transaction. One thing is certain, international transactions create additional difficulties for countries, particularly in tax matters. Tax-related issues in electronic transactions are quite modern, as the laws regulating the transactions cannot be changed as quickly as the information technologies and the opportunities they provide.

As the term "permanent establishment" is practically crucial while conducting international transactions, and the characterization of permanent establishment is one of the most difficult issues of international taxation, it is considered necessary to discuss some of its significant issues in this article. The purpose of the research is to highlight those possible issues, which are connected with permanent establishment while conducting business through e-commerce, which maybe would contribute to the development and improvement of the term "permanent establishment" and the compatibility with electronic transactions.

**Literature review.** Technological innovations and inventions undermine the world economic and legal foundations like never before, because the revolution of information technologies resulted in new types of goods and services, also new methods of business management, which do not reflect the classic categories of transactions.<sup>1</sup>

One can say that the development of e-commerce is one of the greatest events in human history, as every day more and more companies start to use sale advertisements, and other services through the internet, benefiting from the opportunities of the World Wide Web.<sup>2</sup> The economic benefits of e-commerce are mainly connected with the perception that the e-commerce platform offers certain discounts, or other privileges, which brings positive feedback and results in an increase of online shopping.<sup>3</sup>

Though e-commerce continues to develop at a high pace, because of the high competition, many entities engaged in this sector try to attract more

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<sup>1</sup> Cockfield, A. J., 2003 jurisdiction to Tax: The law and economics of digital taxation: challenges to traditional tax laws and principles, p 3, [https://www.researchgate.net/publication/228261238\\_The\\_Law\\_and\\_Economics\\_of\\_Digital\\_Taxation\\_Challenges\\_to\\_Traditional\\_Tax\\_Laws\\_and\\_Principles](https://www.researchgate.net/publication/228261238_The_Law_and_Economics_of_Digital_Taxation_Challenges_to_Traditional_Tax_Laws_and_Principles)

<sup>2</sup> Smith, K. T., 2011. Consumer Perceptions Regarding E-Commerce and Related Risks, p. 1, <https://www.westga.edu/~bquest/2011/ecommerce11.pdf>

<sup>3</sup> Liu Y., Li Q., Edu T., Jozsa L., Negricea I.C. Mobile shopping platform characteristics as consumer behavior determinants. Asia Pac. J. Market. Logist. 2019 doi: 10.1108/apjml-05-2019-0308. [Google Scholar], <https://www.emerald.com/insight/content/doi/10.1108/APJML-05-2019-0308/full/html>

consumers. They think that the contentment of clients from order making process is a crucial indicator of consumer satisfaction.<sup>4</sup> Meanwhile, the contentment of a consumer is connected with his (her) conviction that the provided service will satisfy his (her) needs and expectations.<sup>5</sup> Hence, entities conducting good digital business models should be sure that both seller and the buyer would have certain interests.<sup>6</sup>

The strategy for developing digital markets should include not only ensuring communication in electronic platforms, but also the application of the right policy for advertisements.<sup>7</sup>

For increasing their business incomes, companies use their websites and other digital platforms. But, as internet-based activities are broad and do not involve any boundaries, management and control risks occur. Thus, this type of business may have different issues. Although the reason for many issues is connected with uncertainties in legislation, for solving such issues one needs to have certain skills in the digital economy. One of the main reasons e-commerce being so popular is its beneficial impact, particularly for small businesses.

E-commerce business activities have also some issues, which are mainly associated with the safety of trade organization, reliability, and software improvement.

The research was conducted based on academic articles, books, journals, and the accepted rules of international tax treaties. In this research, the OECD Model Tax Convention was examined and referred to, also its practical implementation, due to the OECD's scale, its research, and analytical approaches. The article includes provisions of the OECD BEPS (Base Erosion and Profit Shifting) program, as it includes strategies for preventing tax planning, which is applied in international practice for regulating legislative gaps, inconsistencies, and inaccuracies. The issue of e-commerce taxation, being one of the most important, is still relevant today. Therefore, one of the most important factors for taxation in e-commerce is the permanent establishment, the discussions of which are ongoing.<sup>8</sup>

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<sup>4</sup> Zhongcheng, L. I. U., Shiyang, H. U., 2017. Study on the evaluation index system of international competitiveness of Chinese private express delivery enterprises. *International Business and Management*, 14(3), p. 27-32, <http://cscanada.net/index.php/ibm/article/view/9469>

<sup>5</sup> Taherdoost, H., 2018. Development of an adoption model to assess user acceptance of e-service technology: E-service technology acceptance model. *Behaviour & Information Technology*, 37(2), p. 179-197, doi:10.1080/0144929X.2018.1427793 [Web of Science ®], <https://www.tandfonline.com/doi/full/10.1080/0144929X.2018.1427793?scroll=top&needAccess=true>

<sup>6</sup> Yin, Y., Stecke, K. E., & Li, D., 2018. The evolution of production systems from Industry 2.0 through Industry 4.0. *International Journal of Production Research*, 56(1-2), p. 848-861, <https://www.tandfonline.com/doi/abs/10.1080/00207543.2017.1403664?journalCode=tp20>

<sup>7</sup> Chaffey, D. & Ellis-Chadwick., 2019 F., *Digital Marketing*, 7rd edition, <https://www.pearson.com/uk/educators/higher-education-educators/program/Chaffey-Digital-Marketing-7th-Edition/PGM2199960.html>

<sup>8</sup> Sanghvi, D., 2016, *Permanent Establishment & Business Profits - Practical Case Studies*, p. 8, <https://www.rashminsanghvi.com/downloads/taxation/international-taxation/PE%20and%20Attribution%20of%20Profits.pdf>

In this sense, the OECD states that profits attributed to a PE are defined by its functions performed, risks assumed and assets used.<sup>9</sup> For instance, as the transfer pricing regulations state, a company gains profit according to its assumed risks.<sup>10</sup>

The term "permanent establishment" in the OECD Model Tax Convention is defined as: "a fixed place of business through which the business of an enterprise is wholly or partly carried on".<sup>11</sup>

Moreover, this definition is the updated version of the one mentioned in the OECD Model Tax Convention of 1963 edition, where the term is defined as the following: "a place of business, where the activities of an enterprise is wholly or partly carried on".<sup>12</sup> Permanent establishment issues have also been addressed by Hendri, Rahayu, N., & Setyowati<sup>13</sup> in their joint article, where it is stated that "The problem arises because the Permanent Establishment (PE) concept in the treaties required a physical appearance to run the business. In the case of e-commerce, none of the e-commerce companies even need a physical appearance to become a marketplace for all", Ruth Agwom Panle & Arinzechukwu Jude Okpara<sup>14</sup> in their article, according to which the application of double taxation treaties is based on the permanent establishment concept, Vincent OOI<sup>15</sup> in his article presents the implementation of electronic transactions in different countries during various matters directly or indirectly related to the permanent establishment.

Thus, from comparing the above-mentioned definitions, it is clear that the updated definition has a wider meaning.

**Research methodology.** Revealing the essence of a scientific theory is tightly connected with its functions performed in science.

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<sup>9</sup> OECD, 2017 Committee on article 7 of the OECD model tax convention on income and on capital, №15, at 177, p. 179,

[https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2017\\_mtc\\_cond-2017-en#page179](https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2017_mtc_cond-2017-en#page179)

<sup>10</sup> OECD 2017, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, p. 146, <https://www.oecd.org/tax/transfer-pricing/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-20769717.htm>

<sup>11</sup> OECD, 2017 Committee on article 5 of the OECD model tax convention on income and capital, №6, at 117 and №144, at 157, p. 119,

[https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2017\\_mtc\\_cond-2017-en#page119](https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2017_mtc_cond-2017-en#page119)

<sup>12</sup> OECD, 1963, Committee on fiscal affairs, model tax convention on income and on capital: Draft double taxation convention on income and capital, art.5, №1, at 3, p. 43,

[http://faculty.law.wayne.edu/tad/Documents/Tax\\_treaties/oecd\\_1963.pdf](http://faculty.law.wayne.edu/tad/Documents/Tax_treaties/oecd_1963.pdf)

<sup>13</sup> Hendri, Ning Rahayu, Mila S. Setyowati, Redefining permanent establishment concept of e-commerce cross-border transaction: A preliminary study in Indonesia, 2021,

<https://scholar.ui.ac.id/en/publications/redefining-permanent-establishment-concept-of-e-commerce-cross-bo>

<sup>14</sup> Ruth Agwom Panle, Arinzechukwu Jude Okpara, The Nigerian Tax Policy on E-Commerce on Social Media: A Study of E-Informal Sector, 2021,

<https://www.scirp.org/journal/paperinformation.aspx?paperid=111730>

<sup>15</sup> Vincent OOI, Adapting taxation for the digital economy in Singapore, 2021,

[https://ink.library.smu.edu.sg/sol\\_research/3296/](https://ink.library.smu.edu.sg/sol_research/3296/)

Some philosophers stated that the history of science is the history of presenting core issues.<sup>16</sup>

Hence, this research discusses significantly important issues, which are crucial for all parties conducting international transactions.

Obviously, companies conducting international activities in different countries would like to avoid double taxation.

For preventing double taxation or double non-taxation in two contracting countries of a transaction, double taxation treaties were developed.

Because of the new emerging issues resulting from the continuing new opportunities given by the internet, the issues discussed in the article were not completely tackled. Because international e-commerce transactions are new phenomena, and facts are emerging, it starts to be necessary to define new issues.

Since analysis is a logical process, it contributes to the division of the question under discussion into several sub-questions and the separate analysis of its components. In contrast, the process of synthesis allows you to identify the general relationship between the components of the subject under discussion. These two processes, acting as one common unit, allow collect, analyze information and discuss all possible issues separately and as a whole. Therefore, it was considered appropriate to implement the article mainly by using the analytical-synthetic scientific method.

Hence, this article raises important issues regarding the taxation of permanent establishments, within the scope of e-commerce, and probable solutions are provided, which may decrease the level of uncertainties in this matter. Based on the above-mentioned, the research also uses exploratory methods with some explanatory and introductory elements.

Based on international best practices and possible core questions that emerged around the issue, a detailed discussion was conducted. As a result, the discussed issues were presented in a diagram.

#### **Findings:**

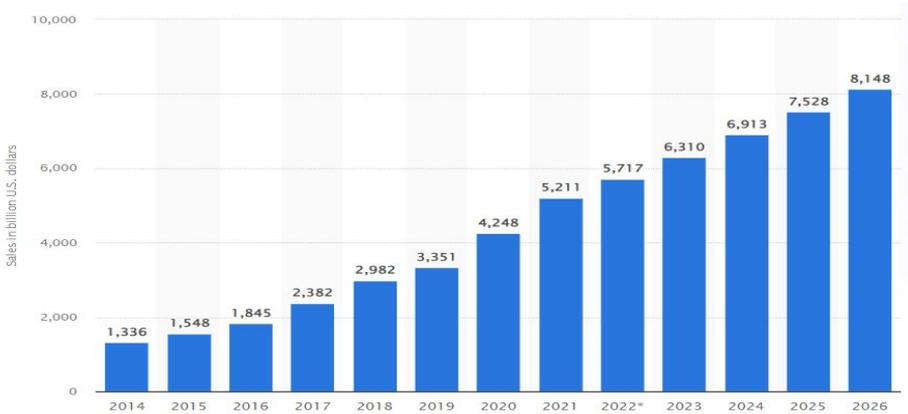
Along with the development of the global digital economy, e-commerce is also developing at a great pace.

Electronic commerce is one of the most important factors in the development of the world economy and the evolution of international economic relations. The rapid development of e-commerce creates opportunities for companies to expand into new markets and reach a large number of customers.

The prevalence of e-commerce in the world is increasing every year. In recent years, e-commerce has become an indispensable method of conducting transactions. In 2021, e-retail sales worldwide will exceed \$5.2 trillion and continue to grow at a rapid pace. Below is statistical information on the volume of retail e-commerce transactions worldwide, according to data from statista.com.

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<sup>16</sup> Poper, K., 1972 *Objektive Knowledge. An Evolutionary Approach*, Oxford, <https://www.amazon.com/Objective-Knowledge-Evolutionary-Karl-Popper/dp/0198750242>



**Figure 1.** Retail e-commerce sales worldwide from 2014 to 2026<sup>17</sup> (prediction)

As a result of the large-scale development of e-commerce, company structures are changing and new business models are emerging. They are characterized especially by the immateriality of the transactions carried out and the decreasing importance of the physical location of the place of business. Governments around the world are faced with the enormous challenge of protecting their revenue base while trying not to hinder the development of either new technologies or growing e-markets. E-commerce allows companies to achieve competitive advantages in customer service.

Countries that want to have a developed e-commerce model must have a well-developed legal framework. However, the peculiarity of Electronic Commerce is the international character of its implementation, therefore the source of regulation of transactions carried out in this way will be effective if it is acceptable by most of countries or defined by model conventions.

Concepts of goods and services in e-commerce are somewhat different from transactions carried out traditionally because the boundary between goods and services in virtual reality is quite close to each other. Legal regulations often differ from country to country, leading to problems related to differences in legislation.

Different countries have different approaches to the taxation of e-commerce transactions. They differ from each other, from the definition of electronic transactions, the scope of inclusion, to the tax rate applied to them. Below are examples of approaches to e-commerce from different countries.

The definition of e-commerce from a tax point of view depends on several factors, especially the definition of subject matter in e-commerce transactions and the purpose of taxation.

The question of the definition of the subject in electronic commerce is quite problematic, especially in cases where the transaction is carried out based on assets that do not have a material basis or electronic services.

<sup>17</sup> <https://www.statista.com/statistics/379046/worldwide-retail-e-commerce-sales/>

Table 1

**Digital taxes in different countries<sup>18</sup>**

<b>N</b>	<b>Country</b>	<b>Start</b>	<b>Description</b>
1	Japan	10.2015	The consumption tax rate is 10%. It is to be charged on all B2C and B2B e-commerce transactions. Digital services such as ebooks and courses do count under this law.
2	Mexico	06.2020	VAT is the consumption tax, which is levied on almost everything sold in the country. The VAT rate is 16% on foreign providers. Digital products include E-books, images, movies, and videos, Downloadable and streaming music, Cloud-based software and as-a-Service products, Websites, site hosting services, internet service providers, Online ads, and affiliate marketing.
3	<b>Norway</b>	07.2011	The VAT rate is 25%. Businesses must register for Norwegian VAT if their annual B2C sales in the country exceed the tax threshold of NOK 50,000. Concerning B2B services, they operate a similar scheme to the EU, where VAT is accounted for by the purchaser under a reverse-charge mechanism.
4	Russia	01.2017	The VAT rate is 20%. all foreign businesses that sell digital products to Russia-based consumers must collect VAT and report to Russian tax authorities. Sellers must also collect two non-conflicting pieces of evidence proving the customer's location (for example billing address, IPN location, bank details, or country code of phone number).
5	<b>Switzerland</b>	01.2010	The VAT is the standard Swiss rate of 7.7% and their registration threshold is CHF 100.000 in global sales.
6	Vietnam	01.2022	The VAT rate is 10%. A digital product is any product that's stored, delivered, and used in an electronic format. These are goods or services that the customer receives via email, by downloading them from the Internet, or by logging into a website.
7	<b>Iceland</b>	11.2011	The standard VAT rate of 22.5% applies to all sales related to electronic services except e-books, which are taxed at the reduced VAT of 11%. The VAT registration threshold is 2.000.000 ISK in any consecutive 12-month period.
8	Serbia	04.2017	The VAT rate is 20% for non-resident providers of electronic services. There is no registration threshold, so foreign businesses must register for VAT in Serbia upon their very first sale. Foreign businesses may need to hire a local tax representative.
9	Taiwan	05.2017	The VAT rate is 5% on digital services provided to consumers by foreign businesses. The registration threshold is NTD480,000. This means foreign businesses that sell to Cambodian customers must watch their total annual sales. When the total surpasses the threshold, that foreign business is required to register for VAT in Taiwan.
10	Chile	06.2020	The VAT rate is 19% for non-resident sellers. There is no registration threshold, so foreign businesses must register for VAT in Chile upon their very first sale.

The subject of taxation is the legal facts that lead to the emergence of tax liabilities.

One cannot equate the subject of taxation with the existence of an object in the physical sense, e.g. income and earning income.

<sup>18</sup> <https://www.quaderno.io/blog/digital-taxes-around-world-know-new-tax-rules#albania>

From a tax perspective, e-commerce issues apply to all commercial transactions in general but are most prominent in transactions involving the processing and transmission of intangible assets, including text, voice, digital image, or a combination thereof.

Based on the legal nature of e-commerce, the rate of growth, the peculiarities of taxation mechanisms, and the insufficiency of existing legal solutions for taxation, there is a need to analyze the problems of taxation of income from e-commerce, which is related to the possible mechanisms of formation of a permanent establishment.

A permanent establishment is a measuring tool for defining the right of a country to tax the profit of a non-resident entity. It is worth mentioning that the profit from an activity will be subject to taxation in the source country if it would be possible to attribute the profit to the permanent establishment that existed in that country. In practice, the term “permanent establishment” has a universal meaning, which is because all conventions are based on the UN and OECD models.

From the definition given by the OECD, it is clear that it has three main requirements.

**1) A place of the business.** A place of business could be a territory for conducting business and in certain cases machines and equipment. Here, the issue is whether the object of business is considered a permanent establishment. Can we consider it as a place of conducting business? In case when the object of business will satisfy other requirements of constituting a permanent establishment, it would be possible to consider it as a permanent establishment. The place of business must be at the disposal of a company. Usually, it is accepted as a "right of use" test. In this case, factual and even illegal use of the place of business shall constitute a permanent establishment.<sup>19</sup> Nevertheless, in the PE context, this point is used for defining the constitution of a permanent establishment.

**2) Fixed nature of the business place.** Meaning that the place of business should be certain and constant. The word “fixed” presumes some relation between the business place and a geographical point. In this case, a question arises, whether it should be considered as a location and an identified place, which is immobile.<sup>20</sup> It is possible that any geographical area, which commercially or economically creates a company, shall be considered a fixed place. But, the existence of a fixed place of business, which is envisaged for performing preparatory and auxiliary functions is not included in the definition of the term “permanent establishment.”

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<sup>19</sup> Reimer et. al 2018, Permanent Establishments, A Domestic Taxation, Bilateral Tax Treaty and OECD Perspective (edited by: Reimer, Schmid, Orell), Kluwer, <https://www.wildy.com/isbn/9789041190482/permanent-establishments-a-domestic-taxation-bilateral-tax-treaty-and-oecd-perspective-6th-ed-hardback-kluwer-law-international>

<sup>20</sup> Govind, H., 2000, Business Connection and Permanent Establishment, <https://www.internationaltaxreport.com/corporate-taxes/business-connection-and-permanent-establishment-in-indias-tax-law--1.htm?origin=internalSearch>

**3) Conducting business activity through a fixed place.** So, a permanent establishment could be considered as existing, when there is a fixed place of business. If the place of business was not established temporarily, it could be considered as a permanent establishment, even though in practice its existence may be for a short period, because of the performed specific activities, or other reasons.<sup>21</sup> The minimal time period for defining the existence of a permanent establishment also could be a matter of disagreement. For instance, according to Dutch practice, a six-month period is enough for constituting a permanent establishment.<sup>22</sup> But, for giving a proper decision on this matter, each case should be discussed, having to regard its specific features.

One of the main issues of taxation of e-commerce is to understand what kind of e-commerce should be taxable. In this regard, different countries have different positions. Some countries are keen on taxing limited transactions conducted via the Internet, while other countries try to tax more types of Internet-based transactions. As a result, there is a situation, where countries do not succeed in creating universally accepted rules to identify sources of income, and effective mechanisms for taxation and income distribution among countries.

So, if there is an effective double taxation treaty between two countries, a non-resident company will be subject to taxation in a country if it has a permanent establishment in that country.<sup>23</sup>

Notwithstanding the universal meaning of the term “permanent establishment”, the nature of e-commerce erodes the place of permanent establishment.

In e-commerce, companies can sell goods and provide services around the world with a very limited physical presence. They can conduct their activities without agents, as they can directly and without any difficulties connect with their consumers from different countries. Thus, the prerequisite of the "permanent establishment" definition – the fixed place of business, is meaningless in e-commerce, because it can be located in any place and conduct business activities everywhere.

As for performing some services, there is no need for a fixed place the OECD Model Tax Convention defines the conditions to constitute permanent establishment while performing services in the other contracting state. In particular, where an enterprise of a contracting state performs services in the other contracting state through an individual, who is present in that other state for a period, or periods exceeding in the aggregate 183 days in any 12 months, and more than 50% of the gross revenues attributable to active business activities of the enterprise during this period, or periods are derived from the services performed in that other State through that individual, the activities carried on in

<sup>21</sup> Azam, R., 2007, Commerce Taxation and Cyberspace Law: The Integrative Adaptation Model, p. 9, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1406416](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1406416)

<sup>22</sup> Pijl, H., 2002, The Concept of Permanent Establishment and the Proposed Changes to the OECD, Commentary with Special Reference to Dutch Case Law, <https://www.ibfd.org/IBFD-Products/Journal-Articles/Bulletin-for-International-Taxation/collections/bit/pdf/bifd110202.pdf>

<sup>23</sup> Cockfield, A., 2002 Designing Tax Policy for the Digital Biosphere: How the Internet is Changing Tax Laws, 34 conn. l. rev. 333, p. 57, [https://www.researchgate.net/publication/228132820\\_Designing\\_Tax\\_Policy\\_for\\_the\\_Digital\\_Biosphere\\_How\\_the\\_Internet\\_is\\_Changing\\_Tax\\_Laws](https://www.researchgate.net/publication/228132820_Designing_Tax_Policy_for_the_Digital_Biosphere_How_the_Internet_is_Changing_Tax_Laws)

that other state in performing these services shall be deemed to be carried on through a permanent establishment of the enterprise situated in that other stat.<sup>24</sup> It is obvious, that the mentioned regulation by introducing time restrictions and profit thresholds is a tool for countries to tax profits at the source country by constituting a permanent establishment.

The final report of BEPS Action 7 states, that the Internet allows non-resident taxpayers to be heavily involved in the economic life of other countries by doing business with consumers located in that country without having a taxable presence therein (such as a substantial physical presence or a dependent agent).<sup>25</sup>

Moreover, e-commerce and the Internet are making it more difficult to apply Permanent establishment (PE) rules, and classification of PE income and assets, as new business models such as online catalogs, virtual communities, subscriptions, online portals and auctions, and digital markets allow taxpayers to conduct business and generate profits in countries without any presence or too little physical presence.<sup>26</sup>

As the profits received from digital goods and services are mobile, therefore, the definition of a PE can limit the right of countries to tax the profits of entities engaged in such kind of activities. So, the BEPS Action 1 imports a new term such as “economically significant presence”, and defines, that if a non-resident company in any country has an economically significant presence based on evident factors that it has a purposeful and sustained interaction with the economy of that country via technology and other automated tools, it would create a taxable presence in that country. To analyze the significant economic presence, the following factors are considered such as **revenue-based factors**, **digital factors**, **user-based factors**, and **possible combinations of revenue-based factors with other factors**.<sup>27</sup>

It is worth mentioning that the following measures are crucially important to consider:

- The revenue generated from other countries on a sustained basis (revenue-based factors),
- Different cultural rules, used domains, local payment options (Digital Factors),
- Monthly active users or online contract conclusions (user-based factors),

<sup>24</sup> OECD, 2017, Committee on article 5 of the OECD model tax convention on income and capital, p. 159, [https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2017\\_mtc\\_cond-2017-en#page159](https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2017_mtc_cond-2017-en#page159)

<sup>25</sup> OECD Action 7 final report, 2015 Preventing the Artificial Avoidance of Permanent Establishment Status, p. 13, <https://www.oecd-ilibrary.org/docserver/9789264241220-en.pdf?expires=1614276293&id=id&accname=guest&checksum=65D759E46CC0A3ADA70C08001F2E97A9>

<sup>26</sup> Basu, S., 2008 International Taxation of E-Commerce: Persistent Problems and Possible Developments, 1 J. of Information, Law and Technology at 2., p. 4, [https://www.researchgate.net/publication/237398015\\_International\\_Taxation\\_of\\_E-Commerce\\_Persistent\\_Problems\\_and\\_Possible\\_Developments](https://www.researchgate.net/publication/237398015_International_Taxation_of_E-Commerce_Persistent_Problems_and_Possible_Developments)

<sup>27</sup> OECD/G20, 2015 Base Erosion and Profit Shifting Project, action 1, p. 107, [https://read.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report\\_9789264241046-en#page109](https://read.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report_9789264241046-en#page109)

- The possible combination of factors (Possible Combinations of the Revenue Factor with the Other Factors).

At the same time, BEPS Action Plan 1 also recommends another policy alternative that may be applied for taxing the transactions in the digital economy by applying withholding tax on payments made by a resident taxpayer on goods purchased and online services utilized from foreign Over the Top (OTT) service providers. However, the need for clarity and simplicity should be balanced with the need to ensure that such transactions of the same type will also be subjected to similar taxes, to avoid incentives for certain types of transactions.

BEPS concerns are going beyond when avoidance of physical presence is combined with tax planning as a result of which the profit generated by that way is not taxed anywhere.<sup>28</sup>

As to a comprehensive report by Colin and Collin the digital revolution is a fact, as the digital economy addresses new challenges to our notions of value creation It should be highlighted that the digital economy divides the place of business from the place of consumption. Therefore, applying the old rules for defining the place of business in digital economy is outdated.<sup>29</sup>

The issues existing in the taxation field of e-commerce are various but mainly connected to the definition of place of transaction. E-commerce can result in issues when defining the constitution of a permanent establishment, the model of which tax conventions do not solve. These unsolved issues can result in additional issues for tax administrations to collect taxes.<sup>30</sup>

Issues to constitute a PE in e-commerce can be summarized in the following questions:

**1. Whether the availability to access some websites for consumers from different countries is a sufficient basis for the owners of the referred websites that they constitute permanent establishments in the countries of consumers?**

As a website does not have a physical presence, it looks like it is a special place, where assets are maintained for storage, exhibition, and delivery. Hence, to insist that access to the website is a satisfactory condition to constitute PE without any other material condition, means that online business should be taxed in every country where the consumers of that company are living. Actually, websites have only agency function which according to existing taxation rules can not constitute PE.<sup>31</sup> So, the answer to this question will be negative.

<sup>28</sup> OECD, Action 1 final report, 2015 Addressing the Tax Challenges of the Digital Economy, p. 79, [https://read.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report\\_9789264241046-en#page81](https://read.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report_9789264241046-en#page81)

<sup>29</sup> Colin and Collin, 2013, Task Force on Taxation of the Digital Economy (English translation) p. 5, 6, [https://www.hldataprotection.com/files/2013/06/Taxation\\_Digital\\_Economy.pdf](https://www.hldataprotection.com/files/2013/06/Taxation_Digital_Economy.pdf)

<sup>30</sup> Catherine L. M., 2002 Balancing Issues and Overlapping jurisdiction in the Global Electronic Marketplace: The ucita example, 8 wash. U. J. L. & pol'y215, p. 239, [https://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=1565&context=law\\_journal\\_law\\_policy](https://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=1565&context=law_journal_law_policy)

<sup>31</sup> McKenzie D., 1996 Commerce on the Net: Surfing Through Cyberspace Without Getting Wet, 14 J. Marshall J. Computer & Info. L. P., 247, <https://repository.law.uic.edu/cgi/viewcontent.cgi?article=1310&context=jitpl>

## **2. Whether the existence of a server constitutes a PE?**

The question to consider a server as a basis to constitute a PE should be discussed thoughtfully, as it is important to understand the purpose of keeping the server. So, if keeping the server has only a preparatory or auxiliary character, there is no constitution of PE. The situation can be more difficult, when the companies are conducting business through many servers “granting” to each server a specific function.

In this case, all servers can not be combined as a single PE, as each of the servers should be analyzed separately to understand the possibility of constituting a PE. Moreover if they even constitute a PE in some circumstances, it can be impossible to attribute profits to that PE (for example, the rule of “force of attraction”), hence it will be impossible to impose taxes.<sup>32</sup> So, there may be possible cases, when a very small amount of profit can be attributable to that server-PE.<sup>33</sup>

**Taking into account the fact that e-commerce has no boundaries, it can be obvious that countries, which will impose taxes based on the location of services can encourage taxpayers to maintain their services outside of the borders of that countries.** However, notwithstanding what countries decide, the notion to consider servers as PE should be agreed upon internationally.

## **3. Whether a mobile phone, computer or any other equipment of consumers constitutes a PE?**

Sometimes, the place of computers through which the consumer concludes contracts can be deemed as a PE for a non-resident. However, this is a place from where the consumer accesses the website and it is difficult to fix. It is difficult to fix the place, especially in cases when a resident taxpayer accesses the website via a mobile phone and is out of that country. So, the question of whether by accessing the website the non-resident taxpayer constitutes a PE has a negative answer as well. This means, that the non-resident can have PEs everywhere, where an internet connection is available.<sup>34</sup>

## **4. Whether the services performed by Internet service providers (ISP) are enough basis to consider that these companies have PEs in that countries?**

Local ISP companies are agents connecting these non-resident companies to local consumers. Therefore, local ISP companies can not be deemed as agents of non-resident ISP companies as they are performing the same services to more than one company. Even considering local companies as agents to those non-

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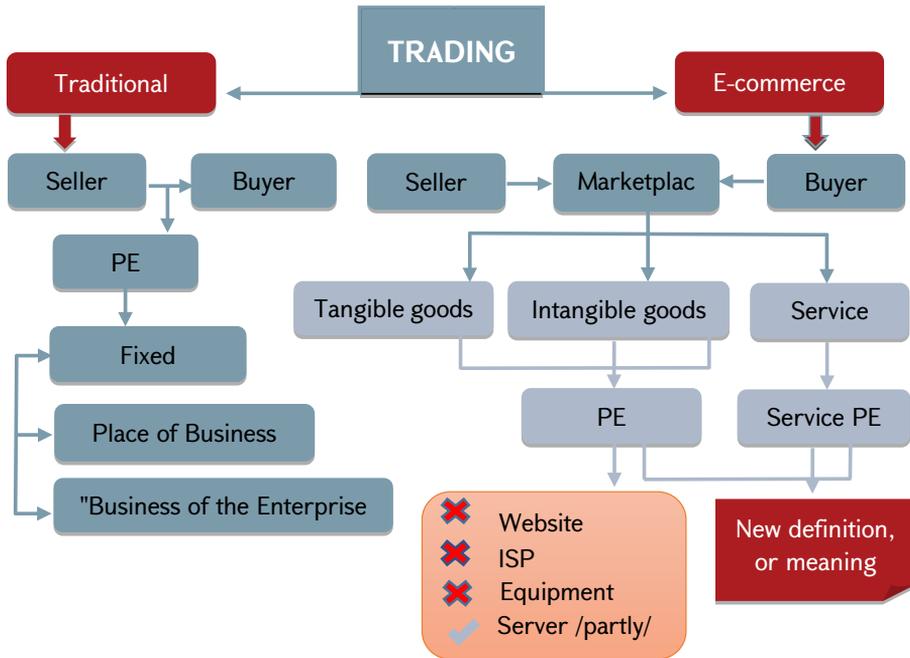
<sup>32</sup> Attribution of Profit to a Permanent Establishment Involved in Electronic Commerce Transactions: A Discussion Paper from the Technical Advisory Group on Monitoring the Application of Existing Treaty Norms for the Taxation of Business Profits, 2001, p. 7, <https://www.oecd.org/ctp/treaties/1923312.pdf>,

<sup>33</sup> Doernberg, R., L., 2001 “Electronic Commerce and Multijurisdictional Taxation” supra note 13, p. 212, <https://www.amazon.com/lfa-Electronic-Commerce-Multijurisdictional-Taxation/dp/9041116834>

<sup>34</sup> Johnson, D. R., 1996 Law and Borders-The Rise of Law in Cyberspace, <https://firstmonday.org/article/view/468/389>

resident companies, the local ones would be considered independent agents. Hence, there will be no basis to constitute a PE.

The following diagram shows all above discussed issues:



**Figure 2. General presentation of problems related to the formation of a permanent establishment**

**Conclusions.** After examining the concept of permanent establishment and issues connected with it, we conclude that the term “permanent establishment” is one of the most important terms of international taxation, as in many cases it is a key factor in some countries for tax administration.

The concept of PE is a fundamental and core aspect of international taxation. Its importance lies in its requirement to determine the right of a country to tax the profits of an enterprise that belongs to a different sovereign jurisdiction. Despite conventions and tax legislations in almost every country dealing with this concept, it yet remains elusive and its characterization gives rise to complex issues in international business taxation<sup>35</sup> The importance of a permanent establishment in the international tax system lies in the fact that it supplants the taxing nexus of the domestic tax law of the host country. A foreign person or enterprise that does not establish a permanent establishment in the host country is exempted from business income taxes. As a result, the decision of whether or not a non-resident company has established a permanent establishment in a given country has enormous financial importance.

<sup>35</sup> Manoj Kumar Singh, Taxing E-Commerce on the Basis of Permanent Establishment: Critical Evaluation, 2014, p. 1, <https://kluwerlawonline.com/journalarticle/Intertax/42.5/TAXI2014034#:~:text=PE%20isdefined%20as%20a,and%20not%20the%20local%20entity.>

While discussing various issues for constituting a PE, the conclusion is that non-resident taxpayers can avoid constituting a PE by classifying their activities as preparatory or auxiliary, or by locating their servers in low, or non-tax jurisdictions. Moreover, resident entities can also relocate their servers to areas having beneficial tax systems.<sup>36</sup> Meanwhile, one should realize that any artificial taxation of commerce would increase the level of such migration. Hence, all the above-mentioned create conditions for taxpayers to decrease their tax liabilities. These opportunities are mainly connected with the uncertainties, and/or unclear provisions of tax codes of those countries involved in e-commerce transactions. Incomes from electronically delivered goods and provided services are new and are not completely corresponding to the local, or international taxation rules.

The analysis of risks connected with the application of the term "permanent establishment" should be observed by companies engaged in international transactions as fair and legal distribution of profits generated from such transactions is very important for these companies. Hence, to avoid future issues, it is necessary to analyze all the bases thoroughly, as the concept of "permanent establishment" is very broad, and there is a possibility that double taxation treaties signed between countries do not cover all aspects of this term.

Thus, before starting a business, it is very important to understand the business environment of a country, as it can be a core issue for both taxpayers and tax authorities. This means that it is important to create such kind of Information and communications technology (ICT) environment, which would support taxpayers in understanding the possibility of the additional tax burden, when making a transaction, without harming tax administration processes.

Therefore, it can be concluded that the ICT medium offered by countries for companies is very important for the realization of e-commerce. For example, in Germany, the small-scale chain store model is used, the main requirement of which is the unified management and service of various types of devices and terminals using one device, such as POS terminals, check cashing systems, telephone systems, computer networks, etc. For example, Huawei uses state-of-the-art ICT technology and cooperates with industry-leading partners to develop different smart retail solutions for different retail features and business scenarios. The Huawei Chain Store Unified Access Solution provides chain stores with integrated access gateways that implement unified access to many services and devices, such as POS terminals, Office Automation (OA), wireless coverage, voice, surveillance, advertisement screens, and ESLs in physical stores. This can speed chain store openings and simplify network management.<sup>37</sup> Estonia has adopted the E-Society model of ICT. This model requires a specific role as an ICT-enabled tools and applications creation or processing hub. As a consequence of domestic demand and internal infrastructure development, primarily in develops IT sphere. The key factors of this model are the following initiatives led

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<sup>36</sup> Avi-Yonah .R, 1996, The Structure of International Taxation: A Proposal for Simplification, 74?a. L. REV. P. 1307,

<https://heinonline.org/HOL/LandingPage?handle=hein.journals/tlr74&div=78&id=&page=>

<sup>37</sup> Huawei, New ICT and Smart retail, 2018, <https://e.huawei.com/topic/leading-new-ict-mx/smart-retail.html>

by the government, such as online governance, online society programs, significant investment in ICT, etc. After all, legislative reforms are required regarding the implementation of e-business activities and the usage of e-government services, such as online tax declaration, online procurement, etc.<sup>38</sup> Armenia has a burgeoning ICT sector. The sector has recorded significant growth in recent years and has seen a continuing expansion of new companies and hiring as Armenia continues to increase its presence in global value chains. There are several notable business areas within the Armenian ICT realm, including customized software, web design and development, IT services and consulting mobile app development, chip design and testing, computer graphics and multimedia, and games. The government is focused on increasingly moving Armenia to a digital society. The Armenian government approved the country's Digitalization Strategy in February 2021. The strategy envisages the digital transformation of the Government, the economy, and the society through the introduction and development of innovative technologies, cyber security, data policy, e-government systems, coordination of digitalization processes, and the creation of common standards.<sup>39</sup>

Hence, for avoiding double taxation, the double taxation treaties should clarify the definition of “permanent establishment” in such a way that it would be acceptable for many countries.

As often e-commerce differs from ordinary commercial activities due to its intangible nature, the domestic regulations of countries sometimes fail to satisfy the requirements, peculiar to international transactions, in this case, defining the place of taxation, thus, it should be accepted that parallel with the rapid growth of e-commerce, we need to have universally and internationally accepted approaches for the taxation of e-commerce, which could globally allow estimating all possibilities and risks emanating from e-commerce.

In the meantime, it is obvious that the attempts of moving the traditional principles of international taxation to the virtual world are failing. The permanent establishment was an effective criterion in the pre-digital age when cross-border commerce required a physical presence to conduct business, this criterion is no longer viable in an age where technology allows buyers and sellers to conduct cross-border business without ever establishing a physical presence in a non-resident state.<sup>40</sup>

Finally, to conclude, unless these issues are tackled, tax base erosion would remain possible, especially in developing and least-developed countries. Thus, maybe there is a need to elaborate new term "permanent establishment" or update its meaning.

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<sup>38</sup> Medium. 2019. Why Estonia Is One Of The World'S Most Advanced Digital Societies, 2019, [Why Estonia is one of the world's most advanced digital societies | by GoGoPlaces | Medium](#)

<sup>39</sup> Armenia - Country Commercial Guide, 2022, <https://www.trade.gov/country-commercial-guides/armenia-information-and-telecommunication-technology>

<sup>40</sup> Eric Flammang, E-business residency: an Australian tax perspective, 2020, <https://williambuck.com/news/business/technology/e-business-residency-an-australian-tax-perspective/>

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## ԷԼԵՆ ԱՎԱԼՅԱՆ

ՀՊՏՀ ֆինանսական հաշվառման ամբիոնի ասպիրանտ

## ԱԼՎԱՐԴ ՍԱՐԳՍՅԱՆ

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տնտեսագիտության թեկնածու

## ՆԱԻՐՈՒՀԻ ԱՎԵՏԻՍՅԱՆ

Տնտեսագիտության թեկնածու

**Էլեկտրոնային առևտրում հարկմանն առնչվող խնդիրների համադրեքստում մշտական հաստատության ձևավորման կարևորությունը.**– Էլեկտրոնային առևտուրը (ներառյալ՝ էլեկտրոնային ծառայությունները) ձեռնարկատիրական գործունեության եղանակ է, որը վերացնում է տարածքային սահմանները և ձեռնարկատիրական գործունեության համար նոր հնարավորություններ է ստեղծում: Էլեկտրոնային առևտուրն ունի մի շարք առավելություններ, սակայն նաև հանգեցնում է մի շարք մարտահրավերների, այդ թվում՝ հարկման ոլորտում: Երկրների համար էլեկտրոնային առևտրին առնչվող գործունեության հարկման իրավունքի հիմքում նման գործունեության իրականացման վայրն է: Թեև միջազգային պրակտիկայում էլեկտրոնային առևտրի հարկման հետ կապված հիմնահարցեր միշտ էլ եղել են, սակայն ներկայումս դրանց թիվն աճում է: Երկրներին մտահոգում են էլեկտրոնային առևտրի հարկման խնդիրները: Այսպես՝ կա մտավախություն, որ, հնարավոր է, չկարողանան գործարքից ստանալ ձևավորվող հարկի իրենց բաժինը: Միևնույն ժամանակ գիտակցում են, որ պետք է ընտրվի հարկման այնպիսի մեխանիզմ, որը չի խանգարի նման գործարքների իրականացմանը:

Հետևաբար՝ էլեկտրոնային առևտրի շրջանակներում եկամտի հարկման վայրի որոշման հարցում կարևոր դեր է խաղում «մշտական հաստատություն» հասկացության սահմանումը, քանի որ դա համարվում է ռեզիդենտ չհանդիսացող կազմակերպությանը հարկելու իրավունքի ձեռքբերման հիմնական գործիք: Ակնհայտ է, որ էլեկտրոնային առևտրի հարկման հետ կապված խնդիրները կարգավորելու համար պահանջվում է միջազգային համագործակցություն, սակայն դա հեշտ չէ հաստատել տարբեր երկրների շահերի հակասության պատճառով:

Համաձայն ՏՀՀԿ հիմնական մոդելի՝ ձեռնարկատիրական գործունեության եկամուտների հարկման իրավասությունը վերապահվում է այն պայմանավորվող երկրին, որտեղ առկա է գործարքի կողմ հանդիսացող մշտական հաստատություն:

**Հիմնաբառեր:** էլեկտրոնային առևտուր, ամրագրված վայր, համացանց, մշտական հաստատություն, շահույթ, սերվեր

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**Важность формирования постоянного учреждения в контексте проблем налогообложения электронной коммерции.** – Электронная коммерция (в том числе электронные услуги) является способом ведения бизнеса, стирающим территориальные границы и открывающим новые перспективы для ведения бизнеса. Электронная коммерция имеет ряд преимуществ, в то же время это новшество приводит к определенным разногласиям в сфере налогообложения. Для стран право на налогообложение деятельности в области электронной коммерции в основном зависит от места осуществления такой деятельности. Хотя в международной практике всегда возникали проблемы с налогообложением в сфере электронной коммерции, в настоящее время число последних увеличивается. Страны обеспокоены налогообложением электронной коммерции, в частности, тем, что они не смогут получить причитающуюся им долю налога от процесса налогообложения, в то же время осознавая, что должен быть выбран такой механизм налогообложения, который не будет препятствовать проведению таких операций.

Следовательно, в рамках электронной коммерции для определения места взимания налога с прибыли важную роль играет определение постоянного представительства, поскольку оно рассматривается как основной инструмент для получения права облагать налогом организацию, не являющуюся резидентом. Очевидно, что для регулирования налогообложения электронной коммерции необходимо международное сотрудничество, но установить такое сотрудничество непросто из-за противоречивых интересов разных стран.

Согласно ведущей модели ОЭСР, компетенция по налогообложению доходов от предпринимательской деятельности предоставляется той стране, в которой существует постоянное представительство стороны сделки.

**Ключевые слова:** *электронная коммерция, фиксированное место, интернет, постоянное учреждение, прибыль, сервер*  
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