



# **DIGITAL PERMANENT ESTABLISHMENT**



## Digital PE - Overview

- Some conceptual remarks
- Digital PE threshold
- Allocation of income
- Conclusions



## Digital PE – Hypothesis

- The physical presence threshold stems from a brick and mortar era
- **If we were to renegotiate the OECD-MC, states would agree on a different PE threshold**

## Digital PE - Justifications

- Two traditional theories (sourcing and benefit theories) can be framed in the context of the new business models in order to keep taxing rights in line with value creation
- The sourcing theory allows countries to exercise their taxing jurisdiction on business income produced on their own territory.
- Its new dimension within the digital economy makes value creation not being depending only on the supply side, but also on the demand side. Accordingly, the market itself can enhance the value of the enterprise and can establish a nexus with the market country, removing the need for a PE concept based on physical presence



## Digital PE – Justifications

- The benefit theory obliges all recipients of services to bear the cost of the community
- Its new dimension within the digital economy gives the market country taxing rights in connection with the benefits and services (e.g. legal system, protection of IP, energy supply, infrastructure...) that it provides to all enterprises that create value on its territory, even in the absence of physical presence



## Why are these theories/principles so persuasive?

- Why should we have taxation where the value is created?
- Why should a state have taxing right if an enterprise obtains public benefits?
- → it is all about sovereignty!
- First conclusion: a global minimum tax as suggested by Olaf Scholz (finance minister Germany) does not solve the issue
- Second conclusion: If we want to allow the market states to tax part of the profit, we need to change the rules



# PE THRESHOLD

## Digital PE – Option 1 – «Hongler/Pistone Proposal»

- Elements of new PE concept for exercising taxing jurisdiction on business income:
- Digital presence - e-commerce enterprises (understood in a narrow sense) will not be affected by the new nexus. Amendments to PE definition (BEPS Action Item 7) already achieve reallocation of income.
- Triple-threshold
  - User threshold (1,000 per month) – key factor, more users being indicators of higher value creation (\*)
  - Time threshold (12 months after user criterion is met) – stability
  - De minimis threshold – avoid excessive fragmentation and burden for SMEs
- (\*) this threshold can be replaced by data or similar threshold related to benefits and value created in market jurisdiction





## Digital PE – Option 1 – «Hongler/Pistone Proposal»

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



## Digital PE – Option 2 – «CCTB-Proposal»

- “If a taxpayer resident in one jurisdiction provides access to or offers a digital platform such as an electronic application, database, online marketplace, storage room or offers search engine or advertising services on a website or in an electronic application, this taxpayer shall be deemed to have a permanent establishment in a Member State other than the jurisdiction in which it is resident for tax purposes if the total amount of revenue of the taxpayer due to remote transactions generated from aforementioned digital platforms in the non-resident jurisdiction exceeds €5 000 000 per year. Furthermore, to determine a significant and sustained digital presence, the Commission shall lay down technical standards for the following digital factors:

## Digital PE – Option 2 – «CCTB-Proposal»

- (a) the number of registered individual users per month that are domiciled in a Member State other than the jurisdiction in which it is resident for tax purposes who logged in or visited the taxpayer's digital platform;
  - (b) the number of digital contracts concluded with customers or users that are domiciled in the non-resident jurisdiction in a taxable year;
  - (c) the volume of digital content collected by the taxpayer in a taxable year.
- If on top of the revenue-based factor, one or more of the three digital factors above as defined by the Commission are applicable for a taxpayer in the relevant Member State, the taxpayer shall be deemed to have a permanent establishment in that Member State."



## Digital PE – Elements of a threshold

- What kind of digital services are covered?
- How to define the threshold - quantitative and qualitative elements
- Reference to value creation or to the benefit principle?



## Digital PE – Allocation of Income

- Options:
  - Use existing transfer pricing rules (and use profit-split method unless an alternative method is more appropriate.)
  - Apply lump-sum allocations without detailed functional analysis
  - Formulary apportionment



## Digital PE – Allocation of Income

- Com (2018), p. 17:
- Profits attributable are those that would have earned if it had been a separate and independent enterprise performing the same or similar activities under the same or similar conditions.
- AOA approach?



## Digital PE – Allocation of Income

- AOA approach:
  - Functional and factual analysis
  - Attribution of assets
  - Attribution of risks
  - Attribution of free capital



## Digital PE – Profit split

- Splitting factors:
  - Numbers of users
  - Amount of data





## Digital PE – Issues Still to Be Solved

- Offset of losses?
- Technical implementation?
- How to consider the interests of small and very small countries/markets?
- Collection of taxes?
- Distortive impact?