2. OECD/G20 BEPS Project in Addressing Tax Challenges of the Digital Economy

2.1. The OECD's Position on 'BEPS'

At the request of G20 Finance Ministers, the OECD conducted an in depth and comprehensive analysis of major Base Erosion and Profit Shifting ('BEPS') opportunities from 2013 to 2015 aimed at identifying its root causes and, consequently, trying to develop possible solutions to tackle the aggressive tax strategies by multinational companies. Action 1 of the BEPS Action Plan specifically analyses the phenomenon of digitalisation from a tax perspective.

The 2015 Final Report on Action 1 in '*Addressing the Tax Challenge of the Digital Economy*' concluded that the digital economy does not create *per se* unique BEPS issues, but some of its peculiarities contribute to exacerbating the existing ones '*because the digital economy is increasingly becoming the economy itself*'.[27] Therefore, the Final Report on Action 1 proposes to use a holistic approach in combination with other Actions of the BEPS Package, in particular, Action 3 recommends defining Control Foreign Company (CFC) income to cover revenue from digital sales;[28] Action 5 recommends adopting a modified 'nexus approach' based on substantial activity to benefit from IP regimes; Action 7 recommends changing the exceptions to the definition of PE combined with an 'anti-fragmentation rule' to limit those exceptions and to restrict activities with a 'preparatory and auxiliary' character;[29] and Actions 8–10 propose new transfer pricing guidance to re-calibrate functions, assets, and risks among multinational entities.[30] The aim of the holistic approach is to ensure that, once the different measures have been implemented in a co-ordinated manner, taxation will be more aligned with the location in which the economic activity takes place.[31]

2.2. Harmful Tax Practices (Action 5)

In today's digital business activities, Intellectual Property (IP) is one of the key assets for creating value and producing income. Due to their intangible nature, multinational companies often move the 'digital core' by choosing a country that offers a preferential tax treatment to locate the legal ownership of the intangible asset in order to reduce their tax liability instead of deriving income from intangibles in the country where they were created or developed. Using preferential tax regimes such

27 OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report*, p. 11.
28 For further details, *see* Gilles Van Hulle, *CFC Rules as a Measure to Address BEPS Opportunities in the Digital Economy*, in this edition.
29 *See* Caroline Amann-Aichner, *The Anti-Fragmentation Rule as an Instrument to Tackle BEPS Problems in the Digital Economy*, in this edition.
30 OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report*, p. 12.
31 OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report*, p. 86.

as high deductions or exemptions of qualified IP income, countries try to attract new investors to the detriment of other countries that do not offer IP regimes.[32]

Moving ahead from the 1998 Report on Harmful Tax Competition[33] which identified 12 criteria to determine whether a preferential tax regime could be considered harmful, the 2015 Final Report on BEPS Action 5 on '*Countering Harmful Tax Practices More Effectively, Taking Into Account Transparency and Substance*' has elaborated new criteria based on the 'substantial activity' in order to reassess taxation of profits '*not only for IP regimes but for all preferential regimes*'.[34]

Aiming at aligning taxation – and, consequently, tax benefits – with substantial activity as requested by the second pillar of the BEPS Project '*which is to align taxation with substance by ensuring that taxable profits can no longer be artificially shifted away from the countries where value is created*',[35] the 'nexus approach' was considered the most appropriate to target geographically movable assets.[36] In order to determine where the substantial activity took place and thus provide that a taxpayer can benefit from a favourable tax regime, the nexus approach focuses on the relationship between the expenditures incurred in the Research and Development (R&D), activity and the benefits from the preferential IP regime.[37] For example, in the case of R&D, activity is assigned to a related enterprise whereby '*the taxpayer will not be entitled to the benefit from an I.P. regime even if it funds the entire activity with its own capital*'.[38]

When several entities are engaged in R&D activities, Action 5 provides a formula to apportion the amount of income that may qualify for any tax benefit.[39]

$$\frac{\text{Qualifying expenditures incurred to develop I.P. asset}}{\text{Overall expenditures incurred to develop I.P. asset}} \times \text{Overall income from I.P. assets} = \text{Income receiving tax benefit}$$

32 OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report*, p. 90.

33 OECD, *Committee on Fiscal Affairs, Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD Publishing, 1998) p. 25 et seq.

34 OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (Paris: OECD Publishing, 2015) p. 9.

35 OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5: 2015 Final Report*, p. 23.

36 Howard M. Liebman/Werner Heyvaert/Valérie Oyen, *'Countering Harmful Tax Practices: BEPS Action 5 and EU Initiatives – Past Progress, Current Status and Prospects'*, *European Taxation* (2016) p. 103.

37 OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5: 2015 Final Report*, p. 9.

38 Stanley C. Ruchelman/Rusudan Shervashidze, *Action Item 5: Countering Harmful Tax Practices Effectively,* Insights (2014) p. 29.

39 OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5: 2015 Final Report*, p. 25 where the definition of the term '*qualified expenditures*' will be provided by the country jurisdiction which offers the preferential IP regime.

Furthermore, on 1 February 2017, the OECD Forum on Harmful Tax Practices (FHTP) in line with Action 5 Final Report, took the 'transparency framework' under review as part of the four BEPS minimum standards in order '*to ensure timely and accurate implementation and thus safeguard the level playing field*'.[40] The transparency framework on Action 5 suggests a specific ruling related with preferential tax regimes and the compulsory and spontaneous exchange of information of an individual country's taxpayers that could be relevant to another country even when the information has not been requested by the second country. Therefore, the compulsory spontaneous exchange of information should always apply for rulings related to *any* such preferential regimes.[41]

2.3. Preventing the Artificial Avoidance of PE Status (Action 7)

The traditional tax balance for allocation rules between residence and source States enshrined in Article 5 OECD Model Convention may be easily circumvented by digital companies due to their ability to access a foreign market jurisdiction without having a local or a minimal physical presence which does not trigger the threshold for determining the taxable nexus to attribute the profits made therein;[42] or by using strategies such as fragmentation of operations or *commissionnaire* arrangements which take advantage of the exception from the PE status under current tax treaties rules.[43]

The 2015 Final Report on BEPS Action 7 on '*Preventing the Artificial Avoidance of Permanent Establishment Status*',[44] following the conclusions made by the Task Force on the Digital Economy (TFDE),[45] contains recommendations to review

40 OECD, *BEPS Action 5 on Harmful Tax Practices – Terms of Reference and Methodology for the Conduct of the Peer Reviews of the Action 5 Transparency Framework*, *OECD/G20 Base Erosion and Profit Shifting Project* (Paris: OECD Publishing, 2017) p. 7.

41 OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5: 2015 Final Report*, p. 49.

42 Committee on Taxation of E-Commerce, *Proposal for Equalization Levy on Specified Transactions, prepared by the Central Board of Direct Taxes, Department of Revenue, Ministry of Finance, Government of India* (2016) p. 38. The report is available at: http://www.incometaxindia.gov.in/news/report-of-committee-on-taxation-of-e-commerce-feb-2016.pdf (last access 22 Mai 2017); Eva E. Lopez, *'An Opportunistic, and yet Appropriate, Revision of the Source Threshold for the Twenty-First Century Tax Treaties', Intertax* (2015) p. 7. *See* also Arthur Cockfield/Walter Hellerstein/Rebecca Millar/Christophe Waerzegger, *Taxing global digital commerce* (Den Hague: Kluwer Law International, 2013) p. 462.

43 OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report*, p. 87.

44 OECD, *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7: 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (Paris: OECD Publishing, 2015) p. 9.

45 The Task Force on the Digital Economy (TFDE) has discussed a number of potential options such as: a) modifications to the exemptions from PE status, b) significant digital presence, c) significant presence d) withholding tax on digital transactions, and e) bit tax, but the Final Report has solely adopted the option to modify the exceptions to a PE status in order to ensure that they are available only for activities that are, in fact, preparatory or auxiliary in nature. *See* OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report,* p. 107 et seq.

the traditional concept of the PE status in order to tackle the use of certain common tax avoidance strategies typically applied by multinational companies with the effect of restoring source taxation in the market jurisdiction.[46]

The suggestions to change the definition of the PE status contained in Article 5 of the OECD Model Tax Convention in order to prevent the artificial avoidance of the treaty threshold below which the market country may not be taxed can be summarised as follows: a) the *dependent agent PE* under Article 5(5) OECD Model Convention arise not only where a dependent agent concludes contracts in the name of the enterprise but also where the agent habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the parent company (so-called *commissionnaire* arrangement);[47] b) *independent agent* under Article 5(6) OECD Model Convention where an agent acts exclusively or almost exclusively for one or more enterprises to which it is closely related, it will not be considered as independent; and c) *specific activity exemptions* under Article 5(4) OECD Model Convention to ensure the exclusion of certain activities considered 'preparatory or auxiliary' in nature (e.g., maintenance of stocks of goods for storage, display, delivery, or processing, purchasing or the collection of information) from the definition of a fixed place of a business PE will only apply where those activities are merely preparatory or auxiliary in relationship to the business as a whole whereas, nowadays, they may correspond to core business activities.[48]

2.4. Transfer Pricing Rules (Actions 8–10)

The ability of multinational companies to segregate the legal ownership (which bears risks and assets) from functions has emerged as a prominent tool of many aggressive tax-planning structures in the field of transfer pricing.[49] As shown in the 2013 OECD Report '*Addressing Base Erosion and Profit shifting*', '*many corporate tax structures focus on allocating significant risks and hard-to-value intangibles to low-tax jurisdictions, where their returns may benefit from a favourable tax regime*',[50] in which the result is to disperse the correct allocation of profits and losses among related entities in different jurisdiction.

46 OECD, *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7: 2015 Final Report,* p. 9.

47 OECD *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7: 2015 Final Report,* p. 15 et seq.

48 OECD *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7: 2015 Final Report,* p. 28 et seq.

49 Yariv Brauner, *Changes? BEPS, Transfer Pricing for Intangibles, and CCAs, University of Florida Levin College of Law Legal Studies Research Paper Series* (2016) p. 3 available at: https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=3288500 (last access 22 Mai 2017); OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report,* p. 78.

50 OECD, *Addressing Base Erosion and Profit Shifting* (Paris: OECD Publishing, 2013) p. 42.

2.2. Weaknesses of the Current Concept of Corporate Tax Residence and Proposed Solutions

Against the background of the above mentioned location-independent management, difficulties in the determination of a single POEM are likely to arise.[35] This may be the case when each relevant manager or director is physically present in a different business office around the world and common meetings are held exclusively via video conferencing. The described set-up is particularly suitable for demonstrating that the previously mentioned OECD Model Commentary position of 'only one place of effective management at any one time'[36] cannot be sustained in modern practice. The same problems would still occur even if these managers or directors appear in person for meetings concerning key management and commercial decisions, but every single meeting takes place at a different location. The latter would be an example for a constantly changing 'mobile place of effective management'[37].

Additionally, multi-jurisdictional cases with the POEM in a third country are conceivable cases for which the current tie-breaker cannot provide a solution.[38] A thinkable scenario for this could be a global consultancy company, ConCo, incorporated in State A with two main offices in the two States B and C. ConCo is a resident in all three States according to the corresponding domestic law. The shareholders of ConCo are its senior consultants who work either in the office in B or in C. Their shareholder meetings are arranged via videoconferencing. Depending on the facts and circumstances (e.g., distribution of senior consultants among the two offices), an analysis of the assumed existing treaty between A and B might lead to the result that ConCo is a dual-resident, but its POEM is neither in A nor B but in C.[39]

This concern is not a particularly new phenomenon and has already been raised by the OECD in a discussion draft in 2001 on 'The Impact of Communications Revolution on the Application of the 'Place of Effective Management' as a Tie Breaker Rule'[40] and a revised follow-up in 2003.[41] The latter discussed two

35 OECD (2001), Technical Advisory Group on Monitoring the Application of Existing Treaty Norms for the Taxation of Business Profits, 'The Impact of the Communications Revolution on the Application of the "Place of Effective Management" as a Tie Breaker Rule' (Discussion Draft), pp. 8–9 (available at: www.oecd.org/tax/treaties/1923328.pdf; date of last access: May 22, 2017).

36 OECD Model Commentary on Article 4, paragraph 24.

37 OECD, Discussion Draft (2001) p. 9.

38 OECD, Discussion Draft (2001) p. 9; but see view of Roland Ismer/Katharina Riemer in: Ekkehart Reimer/Alexander Rust (eds.) *Klaus Vogel on Double Taxation Conventions*[4], Art. 4, m.no. 128, according to which the POEM test leads to a decisive result in a treaty relationship between two countries.

39 Example taken from John F. Avery Jones, *Bulletin for International Taxation* (2005) p. 23.

40 OECD, Discussion Draft (2001) pp. 8–15.

41 OECD, Technical Advisory Group on Monitoring the Application of Existing Treaty Norms for the Taxation of Business Profits, 'Place of Effective Management Concept: Suggestions for Changes to the OECD Model Tax Convention' (2003) (Discussion Draft) (available at: http://www.oecd.org/tax/treaties/2956428.pdf; date of last access: May 22, 2017).

changes that should have been implemented in the OECD Model and its Commentary but which have never found their way into the OECD Model (Commentary). The first recommendation concerned additional guidance in the OECD Model Commentary on Article 4. Additional detailed criteria for determination of the POEM should have been provided in order to determine the place where key management and commercial decisions are, in substance, made.[42] The second recommendation concerned a new Article 4(3) in the OECD Model which wanted to provide a hierarchy test. The POEM was kept as a primary criterion but an economic and formal[43] characteristic of secondary or tertiary importance and a mutual-agreement clause were included as a last resort.[44] Concerning the economic criterion, the discussion draft offered three options. If the POEM tie-breaker did not lead to a clear-cut result, the entity should be deemed to be a resident only in the State (i) with which its economic relations are closer; (ii) in which its business activities are primarily carried on; or (iii) in which its senior executive decisions are primarily taken.[45]

These discussion drafts were widely commented on in literature.[46] The proposed refinement of the OECD Model Commentary was recognized as a positive change but not as a satisfactory final solution.[47] The inclusion of economic criteria was considered as reasonable, especially in light of the challenges posed by ICT.[48] The utilization of a purely formal criterion such as the place of incorporation in the hierarchy test was considered as a controversial issue. On the one hand, it would provide legal certainty and reflect the strongest link of an entity to a certain country if the application of the primary and secondary criteria has not led to clear results.[49] On the other hand, it is prone to manipulation because residence can be created artificially with a purely legal act without any physical substance.[50]

42 OECD, Discussion Draft (2003) pp. 2–3.

43 Which was 'the State from the laws of which it derives its legal status'; OECD (2003), Discussion Draft, p. 3.

44 OECD, Discussion Draft (2003) p. 3.

45 OECD, Discussion Draft (2003) p. 3.

46 *Inter alia,* Richard L. Doernberg/Luc Hinnekens/Walter Hellerstein/Jinyan Li, *Electronic Commerce and Multijurisdictional Taxation* (The Hague: Kluwer Law International, 2001) pp. 373–375; Luc Hinnekens, 'How OECD Proposes to Apply Existing Criteria of Jurisdiction to Tax Profits Arising from Cross-Border Electronic Commerce', *Intertax* (2001) p. 322 (pp. 324–326); Luc Hinnekens, 'Revised OECD-TAG Definition of Place of Effective Management in Treaty Tie-Breaker Rule', *Intertax* (2003) p. 314 (pp. 316–319); Irene Burgers, *Intertax* (2007) pp. 382–386; Confédération Fiscale Européenne, Opinion Statement – Place of Effective Management Concept – Suggestions for Changes to the OECD Model Tax Convention, pp. 3–5 (available at: http://www.cfe-eutax.org/sites/default/files/CFE%20OSt-on%20place%20of%20effective%20management%20concept%20suggestio.pdf; date of last access: May 22, 2017).

47 Eva Burgstaller/Katharina Haslinger, *Intertax* (2004) p. 384.

48 Luc Hinnekens, *Intertax* (2003) p. 317.

49 Eva Burgstaller/Katharina Haslinger, *Intertax* (2004) p. 386.

50 Otto H. Jacobs/Christoph Spengel/Anne Schäfer, 'ICT and International Corporate Taxation: Tax Attributes and Scope of Taxation', *Intertax* (2003) p. 214 (p. 229); Luc Hinnekens, *Intertax* (2003) pp. 317–318; CFE, Opinion Statement, p. 4.

Thanks to these strengths and weaknesses of a purely formalistic residence test, van Weeghel is in favour of a solution which would combine the place of incorporation criterion with a special anti-abuse supplement.[51] The MAP proposal as the final remedy in the hierarchy test was drafted in a way that the intention was questioned by the commentators and, thus, required more guidance.[52] Arthur Cockfield et al. are more in favour of a solution which was already proposed in the discussion draft of 2001 according to which residence should be linked to the place where the directors or shareholders of the company reside.[53] As shown in Section 1.2., this concept is already applied in Australia. Compared to the formal criterion of place of incorporation, this approach has the advantage that it is less subject to artificiality because individuals[54] are less mobile, and it better reflects the place of decision-making.[55] The shortcoming, though, would be that directors and shareholders are possibly situated in different jurisdictions and that especially the residence of shareholders is not necessarily connected to the place of the business of the entity in question.[56] The recommendation by Ismer/Riemer[57] represents one of the most recent comments on the discussion of the concept of corporate tax residence in the pre-BEPS era. After having considered numerous past proposals, in their opinion, the POEM tie-breaker could be improved by the addition of a mutual agreement fall-back clause.

The previous explanations disclose that various proposed solutions concerning the improvement of Article 4(3) OECD Model exist each of which has its own advantages and disadvantages. However, a one-size-fits-all solution does not seem conceivable. Eventually, the discussion drafts did not bring any substantial changes as evidenced by the fact that the proposals did not find their way into the following update of the OECD Model (Commentary) in 2008.[58] As will be evidenced in Section 3.1., the above mentioned recommendation by Ismer/Riemer goes in the direction of the actual BEPS changes.

51 Stef van Weeghel, 'Article 4(3) of the OECD Model Convention: An Inconvenient Truth' in: Guglielmo Maisto (ed.) *Residence of Companies under Tax Treaties and EC Law. EC and International Tax Law Series – Volume 5* (Amsterdam: IBFD, 2009) p. 303 (p. 307), with reference to his own publication: Stef van Weeghel, 'The Tie-Breaker Revisited: Towards a Formal Criterion?' in: Luc Hinnekens/Philippe Hinnekens (eds.) *A Vision of Taxes Within and Outside European Borders: Festschrift in Honor of Prof. Dr. Frans Vanistendael* (Dordrecht: Kluwer Law International, 2008) p. 961.

52 Luc Hinnekens, *Intertax* (2003) p. 318; CFE, Opinion Statement, pp. 4–5.

53 Arthur Cockfield/Walter Hellerstein/Rebecca Millar/Christophe Waerzeggers, *Taxing Global Digital Commerce* (Alphen aan den Rijn: Kluwer Law International, 2013) pp. 474–475; OECD, Discussion Draft (2001) p. 10.

54 Applicable to directors, not necessarily shareholders as pointed out by Otto H. Jacobs/Christoph Spengel/Anne Schäfer, *Intertax* (2003) p. 230.

55 Arhtur Cockfield et al., *Taxing Global Digital Commerce*, p. 475.

56 Otto H. Jacobs/Christoph Spengel/Anne Schäfer, *Intertax* (2003) p. 230.

57 Roland Ismer/Katharina Riemer in: Ekkehart Reimer/Alexander Rust (eds.) *Klaus Vogel on Double Taxation Conventions*[4], Art. 4, m.nos. 137–142.

58 Stef van Weeghel in: Guglielmo Maisto (ed.) *Residence of Companies under Tax Treaties and EC Law. EC and International Tax Law Series – Volume 5*, pp. 304–305.

1. The Blurred Side of the Digital Economy

The importance of the digital economy and its effects were first introduced by Don Topscott in 1995. The digital economy is the result of the widespread and transformative process brought about by Information and Communication Technology (ICT).[1] In his book, Topscott argues that the age of the digital economy is gradually forcing us to rethink the way we perceive the traditional definitions of economy, wealth creation, business organizations, and other institutional structures.[2] Since the digital economy changes the way that we do business, tax laws have been challenged to adapt appropriately to the new business methods.[3] Today, adapting the taxation rules to the digital economy has become necessary.

As a leader organization, the Organization for Economic Cooperation and Development (OECD)[4] has started to change various existing rules and create new ones to deal with the digital economy. However, the OECD has not been fast enough; even more significantly, the full potential of the digital economy has yet to be realized in for properly dealing with the challenges that it poses to taxation.[5] Because many new developments have occurred in the digital economy, both tax authorities and tax payers face various difficulties. Ever since the 18th century, the taxing rules have changed and evolved, but the traditional tax systems have remained more or less the same. On the domestic level, the situation is the same in most countries as tax rules are still based on the 'pre-electronic commerce days'. Yet, the OECD already seemed aware of the challenge of new taxation methods for the digital economy 20 years ago. However, they failed to understand the scale of reforms necessary for tackling the demanding issues of this new economic system. In 1998, the OECD declared that traditional international taxing principles would generally be sufficient for dealing with emerging challenges created by the Internet.[6] However, the OECD's statement no longer looks credible in 2017. Today, the digital economy requires many fundamental changes on both international and domestic levels. It leaves a blurred side of the digital economy.

One of the most debated issues related to taxation in the digital economy is the server of permanent establishment (hereinafter 'PE'). A PE, especially its defini-

1 OECD, *OECD/G20 Base Erosion and Profit Shifting Project 2015 Final Reports BEPS Frequently Asking Question* (Paris: OECD Publishing, 2015), Action 1, Question 11.

2 Don Topscott, *The Digital Economy: Promise and Peril in the Age of Networked Intelligence* (USA: McGraw-Hill Education, 1995) pp. 6–12.

3 Monica Gianni, 'OECD's Flawed and Dated Approach to Computer Servers Creating Permanent Establishments', *UF Law Faculty Publications* (2014) p. 2.

4 The Organization for European Economic Cooperation (OEEC) was established in 1948 to run the US-financed Marshall Plan for reconstruction of a continent ravaged by war. Today, 35 Member countries span the globe from North and South America to Europe and Asia-Pacific. They include many of the world's most advanced countries but also emerging countries like Mexico, Chile and Turkey. (http://www.oecd.org/about/membersandpartners/, last visited May 3, 2017).

5 OECD, *Digital Economy Outlook* (Paris: OECD Publishing, 2015) p. 5.

6 OECD, *Electronic Commerce: Taxation Framework Conditions* (Paris: OECD Publishing, 1998) p. 4.

tion and requirements, is one of the vital concepts of international taxation.[7] In a general principle of international taxation, levying tax requires a resident company or PE in the source country as current tax rules are still based on pre-digital sales models. Scholars and practitioners have focused on the server for two reasons. First, the definition of a PE requires a physical presence. A server is a tangible object and has a physical presence; hence, it may fulfill the requirements of a PE. Second, a server is the core of the digital economy since this economy depends on the Internet which requires a 'server' to provide services to users. In other words, the traditional income tax rules may be adequate to levy tax in one country because a server can be treated as a taxable nexus. This conservatism in adhering to the definition of a PE and trying to fit the system to the definition rather than fitting the definition to the system created a situation where unfair and improper taxation has occurred. Therefore, a new definition of a PE is needed to prevent these unfair and improper taxation practices.

Digital transactions can occur without a physical presence and earn their respective companies significant amounts of revenue, therefore, focusing on a physical presence does not facilitate adequately taxing this new type of business activity. The digital economy is conducted via a worldwide network that lacks a central physical presence and provides businesses access to markets and customers around the globe. Thus, it is difficult to apply current PE rules with its needless attention to physicality.[8] In fact, the current PE requirements cause burdensome obstacles when they are applied to the digital economy. For instance, the current PE definition excludes preparatory and auxiliary activities. Yet, many activities fall under that definition within the confines of the digital economy. As a result, creating a new definition of a PE has become urgent in order to cope with the new challenges.

In response to the need for a new definition of PE scholars, judges, and different working groups of the OECD have proposed several different definitions. The projects of the European Union[9] and the OECD Base Erosion and Profit Shifting[10] are steps in the right direction for resolving an untenable situation.[11] Neverthe-

7 Arthur Cockfield, 'Should We Really Tax Profits from Computer Servers? A Case Study in E-Commerce Taxation', *Tax Notes International* (2000) p. 21.

8 Richard Westin, *International Taxation of Electronic Commerce*, *2nd Edition* (The Hague: Kluwer Law International, 2000) pp. 211–280.

9 The European Commission is pursuing an ambiguous campaign for a coordinated European Union approach against tax avoidance. In January 2016, the European Union has published an anti-tax avoidance package which consists of an anti-tax avoidance directive, a recommendation on tax treaties, an administrative cooperation directive, external strategy for effective taxation, and a chapeau communication and staff-working document.

10 BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity.

11 Monica Gianni, 'OECD's Flawed and Dated Approach to Computer Servers Creating Permanent Establishments', *UF Law Faculty Publications* (2014) pp. 15–18.

less, the OECD still has not made any significant changes in the situation. The current state of affairs creates unfair taxation for developing countries which is against the aim of taxation. As Justice Oliver Wendell Holmes stated, *'Taxes are the price we pay for civilized society'*.[12] Though, in respect of a server PE, the one who earns the most does not pay the price.

The solution is a new PE definition that is based on value creation through websites. While arguing that a server is a PE, many scholars have also discussed the possibility of using websites as a PE.[13] Because of the different kinds of business models used in the digital economy, such as the customer to business model, websites are the heart of the digital economy. They are crucial because both customers and companies use them in numerous ways such as advertisements or online purchasing. A server is a narrower concept in the digital economy because a server can provide service to many countries without being located in them. On the other hand, a website can be effectively used to determine the level of economic activity by a company within that country. Therefore, websites have become more important for the new definition of a PE.

2. Definition of a PE and a Server

2.1. Importance of Definitions

Practitioners, scholars, and the OECD have made the case for considering a server as a PE because of the unique characteristics of a server. The OECD Model Convention (MC) commentary on Article 5 demonstrates the OECD's attitude towards whether a server constitutes a PE or not: the OECD states that 'a server may constitute a PE'[14] which is a controversial attitude due to its uncertainty in that the commentary accentuates the need to understand the definition of a PE as it is critical for understanding in which circumstances the OECD considers a server as a PE.

Moreover, it is vital to focus on the definition of a server and the definition of a PE in order to understand why there is a huge discussion on a server PE and why there is a necessity for a new definition. The OECD MC provides a complicated definition, especially in respect to the digital economy; for instance, the definition requires physical presence whereas companies can set up a business model in the digital economy without any physical presence.

12 Oliver Wendell Holmes Jr. (March 8, 1841–March 6, 1935) was an American jurist who served as an Associate Justice of the Supreme Court of the United States from 1902 to 1932 and as an Acting Chief Justice of the United States January–February 1930.

13 Arthur Cockfield, 'Balancing National Interest in the Taxation of Electronic Commerce Business Profits' *Tax Notes International* (2009) p. 13.

14 OECD Model 2014 Commentary on Article 5.