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# **DIGITAL PERMANENT ESTABLISHMENT**

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**Abstract:** The permanent establishment (PE) has always been of interest in the field of international taxes in the taxation of profits of foreign enterprises in the source state. Over the years, the PE concept has undergone a number of changes. Their manifestation is reflected both from theoretical and practical perspective in connection with the variety of cases on this matter. Over the last years, the idea of digital PE has been subject of discussion both at worldwide and at European level. The current study analyzes the possibility of its introduction through the double tax treaties (DTTs) and the European Union law (EU law). In this regard, the measures undertaken in the legislation of different states are also examined.

**Key words:** permanent establishment, digital economy, double tax treaties, European Union, significant digital presence.

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## **Introduction**

**T**he growing digitalization of business, the dynamic international relations, as well as the number of tax reforms worldwide also reflect on the PE's legal nature. On the one hand, the concept is with long history and well-established postulates. On the other hand, as can be seen from the latest version of the OECD Model Tax Convention on Income and on Capital (OECD-MC) of 2017, some of the texts related therewith has undergone a number of changes in relation to the modern needs.

Legislative amendments have been carried out regarding the possibility of constitution of the so-called 'digital PE' in some countries. There is

also proposal for a council directive of the European Union and international practical cases on this issue.

Given the above arguments, necessity of analyzation on the extension's possibility, whether the digital PE's inclusion is a good option, arises.

## I. Digital PE in the OECD-MC

The possible introduction of digital PE in the long-standing concept of Art. 5 of the OECD-MC logically determines the need to examine where it should be placed in the provision in question. For example, the basic rule – Art. 5, para 1 of the OECD-MC, requires fixed place at a certain geographical area, characterized by permanency.<sup>1</sup>

As can be seen from its text, it is both theoretically and practically challenging to add the digital PE therein. It will be in contradiction with one of the necessary prerequisites for the PE's constitution. Moreover, the basic rule has not undergone amendment from its introduction in the first OECD-MC to its latest version. This would reflect entirely on both the established postulates of the concept and the subsequent texts of this provision, which are directly related thereto (e. g. Art. 5, para. 2 of the OECD-MC). On the other hand, however, the OECD-MC Commentary (Commentary) to Art. 5, para 1 of the OECD-MC contains separate paragraphs on e-commerce. They may be construed as attempt for concept's further development through the prism of the modern needs.

There is also a proposal for amendment of this provision in the international doctrine (Lapina, Mikhaylova-Goleminova, Ivanov, 2020)<sup>2</sup>. This view itself looks innovative and tries to combine the traditional concept with the idea of taxation of digital economy. However, I believe that this would lead to a possible ambiguous interpretation, as well as it would reflect on other paragraphs of Art. 5 of the OECD-MC (e. g., the preparatory and auxiliary activities under Art. 5, para 5 of the OECD-MC, etc.).

Can the digital PE be placed in the so-called 'positive catalogue' of Art. 5, para. 2 of the OECD-MC? Based on the variety of PE's examples, which should be not interpreted narrowly, it could be concluded that digital economy may be separate sub-item or even part of the 'natural resources' under Art. 5, para 2, l. 'f' of the OECD-MC (Petruzzi, Buriak, 2019).

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<sup>1</sup> Art. 5, para 1 of the OECD-MC: 'the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on'.

<sup>2</sup> 'A place of business through which a company fully or partially regularly conducts entrepreneurial activities (including digital presence), as well as in which it has a source of users and an income-generating place'.

However, I consider that such approach needs to be carefully examined, especially how this will affect the practical aspect of this issue. I share the opinion that such idea is fairly possible at this stage for several reasons. First, various examples are outlined in Art. 5, para 2 of the OECD-MC that follow the requirements under Art. 5, para 1 of the OECD-MC. Based on the digital economy's nature, it does not meet basic rule's criteria. Second, this list of examples has not been explicitly added with new hypotheses over the years. The only significant amendment is the differentiation of new Art 5, para 3 of the OECD-MC in 1973. This does not automatically lead to the conclusion that it is impossible to include new examples, but in my opinion this would not be the case with the digital PE.

It is impossible to add such text to Art. 5, para 3 of the OECD-MC due to its specific nature. The provision in question outlines the building site, the construction and the installation project as PE's forms. Based on their legal nature and the objectives pursued, they should be situated at particular geographical point.

Such view can not be expressly shared for Art. 5, para 5 of the OECD-MC - the dependent agent's figure. In this case, no geographical location is necessary, as the agent, who carries out this activity, is relevant and in particular upon conclusion of the principal's contracts. I consider that it is possible digital PE's constitution under this hypothesis in certain cases.

Intriguing is Art. 5, para 3, l. 'b' of of the United Nations Double Taxation Convention between Developed and Developing Countries (UN-MC), the so-called 'service PE'. This text also appears in the Commentary as an alternative one. The leading factor here is the 183-days presence within a 12-month period in the source state and not the fixed place of business. In this way, it is closer with digital PE's idea.

Arguments regarding the possibility of digital PE's introduction are expressed in the international literature. For example, Bal is on the opinion that cloud providers may easily circumvent the source taxation based on their legal nature (Bal, 2014). This also reflects on their taxation of business profits. It is also a kind of proof that the current PE concept is ineffective in relation to the activities in question.

Brauner and Moreno suggest the inclusion of provision similar to Art. 10, para 4, Art. 11, para 4 and Art. 12, para 3 of the OECD-MC. Other authors share the view that Art. 5 of the OECD-MC should expand its scope regarding e-commerce (Bohórquez, 2016). In this regard, however, the provision of Art. 7 of the OECD-MC, which determines taxation of business profits, should be reconsidered. Taking into account the underlying principles, these authors believe that the digital PE is consumer neutral in the source state. It is also

efficient, as the connection between the digital service and the end customer can be established.

Blum is on the view that a welcoming idea is to introduce digital service PE (Blum, 2015). In this way, the problem regarding the ratio in relation to Art. 5, para 1 of the OECD-MC will be solved. The question remains whether this is the most feasible option and what is the situation with the DTTs that do not have a clause similar to Art. 5, para 3, l. 'b' of the UN-MC. Blum's proposal is symbiosis of the traditional, the rational and the modern and it deserves admiration.

According to Schön (Schön, 2017), it is possible that different factors/thresholds on digital PE's existence may be applicable – quantitative (number of active users, number of registered users, amount of costs, etc.) and qualitative (availability of local domain, local digital platform, etc.).

Hellerstein analyzes the digital PE from theoretical and practical perspective (Hellerstein, 2014). The first is not characterized by certain changes – the introduction of new text should respect the established international postulates and should not cause any ambiguity. In practice, however, a number of issues may arise. Today's rapidly evolving technological world is constantly creating innovations. Can some of them be aimed at circumvention of digital PE's constitution, influencing the enterprise's activities? Another disputable moment is whether the enterprises themselves can meet the technological requirements and how this will reflect on their competitiveness. On the one hand, small enterprises will find it difficult to fulfil the criteria which would lead to digital PE's non-constitution. On the other hand, large enterprises may not avoid the outlined requirements and they will most likely meet the necessary prerequisites.

The proposal expressed in connection with the consultations on 'significant presence' under Action 1 of the BEPS Project<sup>3</sup> is also intriguing. It suggests distinctive features such as: relationships with clients or users lasting more than 6 months in combination with certain physical presence directly or through an agent, sale of goods or services through means involving close contact with clients within the state, including through a website in the local language, offering supplies from suppliers within the state, using banking and other facilities by suppliers within the state or offering goods or services to customers within the state, arising from or involving the systematic data collection or transfer of content by persons within the state.

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<sup>3</sup> BEPS Project is an initiative of the OECD and G20 and is a Multilateral Convention on the Implementation of Action Plans Related to Tax Arrangements to prevent Base Erosion and Profit Shifting. It consists of 15 Actions, some of which are minimum standard, i.e. they should be included into the domestic law. Action 1 is named 'Tax Challenges Arising from Digitalisation' and concerns this issue.

In a detailed study, Hongler and Pistone suggest the introduction of separate text on digital PE as a last paragraph of Art. 5 of the OECD-MC (Hongler, Pistone, 2015). It is noteworthy that it resembles the idea expressed by the European Commission (EC) on its proposal for directive on this issue, which is analyzed in the next section of this paper.

Their detailed survey deserves admiration. They emphasize on the main PE postulates, the relationship between the new paragraph and the VAT, as well as other DTT's provisions, its typical characteristics, etc. However, I do not share their idea for several reasons.

On the one hand, the Commentary contains some texts regarding e-commerce from Art. 5, para 1 of the OECD-MC perspective. If a new paragraph is added, they should be deleted.

On the other hand, the new paragraph will inevitably reflect on the way of PE's profit taxation under Art. 7 of the OECD-MC. That is why, the need for appropriate amendments should be made in this regard. Question arises how this will affect the overall PE's concept and whether such approach is actually the best option. It should be borne in mind that the digital PE would also likely reflect on national domestic legislation with the possibility of some deviations due to national sovereignty and needs.

Another approach is the introduction of lower threshold on the PE's constitution and in particular the time criterion. Art. 17 of the OECD-MC may be illustrated as an example. I do not consider this as a good option for several reasons.

First, when negotiating a DTT, states may change certain criteria regarding the PE, including the time of its establishment. Second, the lack of any threshold would both radically influence the current concept's perception and may lead to immediate PE's constitution. Third, the provision of Art. 17 of the OECD-MC is *lex specialis* compared to Art. 15 of the OECD-MC, as the latter contains the time requirement. Moreover, these two texts have different purpose. Last but not least, such measures hide various practical challenges and the possibility of abuses, rather than providing a long-term solution for this problem.

I share the view that the measures for digital PE's introduction are rather overdue. Online services have been long time an integral part of our modern life and their diversity determines the possibility of heterogeneous tax treatment. No universal solution may be found in this matter, but the introduction of new rule, that would undergo further modifications over the years, is a welcoming idea.

Following the principles established in the OECD reports on this issues, there should be no difference in the treatment of normal and online trade. In this regard, opinion that the introduction of new provision is the

more rational option is expressed (Spinosa, 2018). Paragraph 1 thereof should contain the rule that the resident state may tax the income arising from specific digital services or activities. Pursuant to paragraph 2, the market state may tax the income in question if a certain threshold is exceeded. Paragraph 3 examines the services or the activities in question that may fall within the scope. By PE's existence, pursuant to paragraph 4, the provisions on its business profits will have priority. For this purpose, paragraph 5 will be introduced, which will outline the rules on taxation in the source state. The last paragraph 6 will be the so-called 'special relationship provision'.

I agree with such a proposal that tries to regulate this matter in the most objective and appropriate way. As further recommendations, it may be clarified that paragraph 3 contains a non-exhaustive, illustrative list due to variety of cases. It is also possible that a rule regarding the intentional circumvention of the provision similar to Art. 5, para 4.1. of the OECD-MC to be introduced.

After this brief analysis of the structure of Art. 5 of the OECD-MC and the different ideas shared in the doctrine, I am on the opinion that an appropriate option is the introduction of a separate stand-alone provision that examines this issue. It may resemble the PE's concept in some aspects and even be thereafter (e.g. Art. 5A), but it should be independent pursuing different goals. Such approach will not affect the established PE's postulates. It will rather mark the beginning of the new concept, which will be supplemented and upgraded over the years. However, this will also reflect on the way business profits be taxed. In general, there may be two options – the introduction of new Art. 7A or separate paragraph of Art. 5A.

## **II. Digital PE in the EU law**

At European level, EC initiated Proposal for a council directive laying down rules relating to the corporate taxation of a significant digital presence (Proposal) from 21.03.2018. This is directly related with Action 1 of the BEPS Project, as well as with the idea of common consolidated corporate tax base. The Proposal introduces the term 'significant digital presence' and outlines the rules for taxation of its business profits. Pursuant to Art. 1 of the Proposal, its main subject is the extension of the PE's concept.<sup>4</sup> Brauner and

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<sup>4</sup> Art. 1 of the Proposal: 'This Directive lays down rules extending the concept of a permanent establishment, as it applies for the purposes of corporate tax in each Member State, so as to include a significant digital presence through which a business is wholly or partly carried on'.

Pistone oppose the introduction of directive on this matter, based on the principle of subsidiarity (Brauner, Pistone, 2017).

Item 8 of the Proposal's preamble outlines its main objective – 'to improve the resilience of the internal market as a whole in order to address the challenges of taxation of the digitalised economy'. In this regard, question about the relationship between the Proposal and the EU fundamental freedoms, such the freedom of establishment, arises. Pursuant to the term 'significant digital presence' under Art. 4 of the Proposal certain categories of subjects fall into. It can be concluded, for example, that this leads to different tax treatment compared to enterprises that do not provide digital services.

The European Court of Justice (ECJ) prohibits any discrimination against the freedom in question aiming at equal treatment (para. 29 and 30 of the ECJ judgement on case C-233/16). Despite the distinguishing criterion, which entities are taxable due to significant digital presence and which are not, I do not consider that it is contrary to the EU law postulates. Nor does it constitutes indirect discrimination that reflects on one of the fundamental freedoms. Such restriction is permissible if it is 'justified by overriding reasons in the public interest' and 'ensuring the attainment of the objective in question and not go beyond what is necessary to attain that objective' (para 42 of the ECJ judgement on case C-385/12 and para 42 of the ECJ judgement on case C-371/10).

Art. 4, para 1 of the Proposal introduces the digital PE similar to Art. 5, para 1 of the OECD-MC.<sup>5</sup> On this way, part of the text of the latter provision is incorporated ('through which the business of the enterprise is wholly or partly carried on'). However, instead of use the term 'place', associated with objective geographical perception, the term 'presence' is used, emphasizing on its diversity.

Pursuant to Art. 4, para 2 of the Proposal, the digital PE develops the concept, without conflicting the traditional perception (Petruzzi, Koukouloti, 2018). It may be concluded that there is no competition between this provision and the basic rule under OECD-MC.

Art. 4, para 3 of the Proposal outlines the necessary requirements for significant digital presence's existence. It is noteworthy that the term 'supply of digital services' is used, which is terminologically close to the VAT regime. Such approach is unknown in Art. 5 of the OECD-MC and leads to subsequent discussions.

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<sup>5</sup> Art. 4, para 1 of the Proposal: 'For the purposes of corporate tax, a permanent establishment shall be taken to exist if a significant digital presence exists through which a business is wholly or partly carried on'.

The term ‘digital interface’ is also included in Art. 4, para 3 of the OECD-MC, which definition is outlined in Art. 3, para 2 of the Proposal.<sup>6</sup> Theoretical question arises whether the use of the term ‘including’ includes mobile applications to the software or whether they are two separate terms. My understanding is that they are rather typical examples of the first option.

The definition ‘digital interface’ also uses the phrase ‘accessible by users’, but it does not explicitly outline what its varieties are, i.e. how it can be performed. Such approach seems logical for several reasons.

First, this will unnecessarily burden the wording of the definition itself. Second, it is difficult to cover all possible cases, as the most common forms of access are well known. Third, the term itself is rather technical and it is impossible to examine all hypotheses.

Another relevant for the PE’s concept term is ‘associated enterprises’. By closer look, it is evident that there is difference between Art. 3, para 9 of the Proposal and Art. 5, para 8 of the OECD-MC regarding ‘closely related enterprises’. While in the first case the derived quantitative criterion for associated enterprises is 20 %, it is 50 % in the second. There are also other qualitative differences. For example, the beneficial interest is introduced in the OECD-MC. It is intriguing why the Proposal’s threshold is two times lower in comparison with the OECD-MC. The debatable question here is which criteria should be applied by DTT’s conclusion – those under Art. 3, para 9 of the Proposal or those under Art. 5, para 8 of the OECD-MC.

Art. 4, para 3 of the Proposal alternatively presents the conditions for significant digital presence’s existence in three sub-items. According to l. ‘a’ thereof, as first possibility, the relevant criterion is total user revenue.<sup>7</sup>

In connection with the term ‘user’, which pursuant to Art. 3, para 4 of the Proposal can be any individual or business, the following questions arise. First, it is not explicitly stated whether the users in question are residents and/or nationals of the Member State or whether their physical presence at particular geographical point is predominant. For example, should a few hours’ stay in a given area fall within the scope of the first hypothesis in question. The use of ‘any’ in the definition may lead to affirmative answer, but in my opinion there is still risk of ambiguous interpretation. The Bulgarian Proposal’s translation does include ‘any’ and may lead to uncertainty regarding this issue.

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<sup>6</sup> Art. 3, para 2 of the Proposal: ‘digital interface’ means any software, including a website or a part thereof and applications, including mobile applications, accessible by users’.

<sup>7</sup> Art. 4, para 3, l. ‘a’ of the Proposal: ‘the proportion of total revenues obtained in that tax period and resulting from the supply of those digital services to users located in that Member State in that tax period exceeds EUR 7 000 000’.



Second, by cancellation's service in state A and its subsequent performance in state B, the question here is how the realized income is calculated – according to the payment of the service or according to the actual location of its performance. If the second view is shared, the inquiry how the user will be treated remains if the activity is carried out in several parts in different states. Last but not least, it should be determined whether it is the users and not the transactions themselves that generate revenue.

Another disputable moment is the exact amount of EUR 7 000 000. On the one hand, this may lead to its deliberate circumvention. On the other hand, different Member States have different economic growth and consumer power. It is difficult to compare Bulgaria's economy with Germany's, as well as to draw parallel between Luxembourg and France. In this connection, query arises as to what extent the established threshold can not be determined according to other indicators that analyze more objectively and fairly the specific situation in the given Member State. However, this will further complicate the challenging matter and it may lead to other theoretical and practical challenges.

Art. 4, para 7 of the Proposal determines how the share of total revenues is calculated.<sup>8</sup> What matters is the number of times the device is used and not the users' location. It is not clear whether a local domain or a foreign one should be used, as long as the device is within the state.

The second alternative hypothesis focuses on the number of users.<sup>9</sup> The same arguments regarding the number as to the revenues under l. 'a' are also applicable here. In this case, the number and not the location is relevant criterion for PE's constitution, which differs from the traditional perceptions of the concept. In my opinion, user's number in Luxembourg and Germany is incomparable for a certain period of time. The definition of 'user' is too general and it allows the possibility for broad interpretation. As the only condition is that the user is in the state, his resident status or his residence period are irrelevant. It is also unclear whether the one-off, incidental or short-term use of digital service at the airport, the port or the land border itself should be included. Due to the lack of laid down criterion, the answer should be affirmative.

Another intriguing moment is whether the use of several accounts by one user is considered as one, as only one person uses them, or it should be

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<sup>8</sup> Art. 4, para 7 of the Proposal: 'The proportion of total revenues referred to in paragraph 3(a) shall be determined in proportion to the number of times that devices are used in that tax period by users located anywhere in the world to access the digital interface through which the digital services are supplied'.

<sup>9</sup> Art. 4, para 3, l. 'b'" of the Proposal: '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'.

counted according to their exact number. Minors, who are unable to use specific digital service due to age criterion, may still access it if they have the necessary adult's data. Such actions are difficult for control and detection which supposes the possibility of biased calculation of the exact number.

Possible challenge may be also when the service starts in state A, continues in state B and ends in states C. Assuming that there is definition of 'digital services', it should not be estimated to what extent is preparatory or ancillary one and therefore non-constituting a PE in this case. Perhaps the most logical approach is to tax each part of the service in the respective state, but it is not entirely clear whether this is the purpose of this hypothesis. Complications may also occur by its use of different users. Given the technological progress, it is possible to purposefully manipulate the exact number. Practical difficulties may also arise by VPN's use. I believe that there is risk of double taxation on these cases.

Although Art. 4, para 4<sup>10</sup> of the Proposal tries to clarify this second hypothesis, the above mentioned issues are only part of the possible challenges on this matter. Its introduction seems close with VAT regime and departs from the PE's established principles.

Numerous challenges by application of Art. 4, para 3, 1. 'b' of the Proposal call into question its effectiveness and the objectives pursued. I support the position that based on the different degree of economic development and needs, a welcoming idea is that this criterion not be the same for all states, but to be calculated on the basis of certain factors (Brauner, Pistone, 2017). Such approach would more objectively outline the actual economic situation in the state concerned.

The third alternative hypothesis is outlined in Art. 4, para 3, 1. 'c' of the Proposal.<sup>11</sup> The number of business contracts, that must be reached, is again specified. Art. 4, para 5 of the Proposal tries to clarify this hypothesis, but number of issues raise again.<sup>12</sup>

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<sup>10</sup> Art. 4, para 4 of the Proposal: 'With respect to using digital services, a user shall be deemed to be located in a Member State in a tax period if the user uses a device in that Member State in that tax period to access the digital interface through which the digital services are supplied'.

<sup>11</sup> Art. 4, para 3, 1. 'c' of the Proposal: '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 Member State exceeds 3 000'.

<sup>12</sup> Art. 4, para 5 of the Proposal: 'With respect to concluding contracts for the supply of digital services:

(a) a contract shall count as a business contract if the user concludes the contract in the course of carrying on business;

(b) a user shall be deemed to be located in a Member State in a tax period if the user is resident for corporate tax purposes in that Member State in that tax period or the

Art. 4, para 5, l. 'a' of the Proposal defines the scope of the contracts in question. There is, however, no definition of 'carrying on business' similar to Art. 3, para 1, l. 'h' of the OECD-MC. In my opinion, the latter is also relevant to the case.

On closer examination of what is 'business contract', several issues should be taken into account. First, not the form, but the substance is the relevant factor, i.e. 'the substance over form' approach is applicable. Second, it is not clear what is the situation when this contract is 'mixed', i.e. there are elements of both business and non-business activity. Several options are possible.

The most definite and probably not so rational is that this contract should not be defined as business at all due to the presence of non-business elements. The opposite understanding may also exist - if there are business clauses, it should be business contract. Another option is to determine the ratio of business and non-business clauses, which, however, would be rather difficult, especially when they are almost equal.

Art. 4, para 5, l. 'b' of the Proposal introduces the requirement the user to be resident for corporate tax purposes in that Member State or in a third country but to have a PE in the Member State in question. The possible inquiry in this case is on the possibility of two PEs – one under Art. 5 of the OECD-MC and the digital. If the answer is affirmative, then it is even more intriguing the profits attribution, if the PEs are of different enterprises. If the answer is negative, then the provision is rather vague and misleading.

The brief analysis of the significant digital presence highlights only some of the possible challenges related with the digital PE. The outlined seven paragraphs of Art. 4 of the Proposal seem to raise more questions and possibilities for ambiguous interpretation than to outline its legal nature in clear and definite way. That is why, I would suggest completely rethinking whether the Proposal's idea will actually meet the objectives pursued and whether it should at all be defined as a new PE.

Another interesting aspect is that the definition of 'digital services' under Art. 3, para 5 of the Proposal is textually closer to the definition of 'electronically supplied services' under Art. 7, para 1 of the Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax (Cid, Gutiérrez, González-Barreda, 2019). Probably the idea was that there should be no difference in the terms used both from direct and indirect taxes perspective, but it is disputable how appropriate is it to unify

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user is resident for corporate tax purposes in a third country but has a permanent establishment in that Member State in that tax period'.

this issue. The abovementioned authors analyze detailed the services that fall within the scope. For example, they do not find definition of ‘digitized product’ and they outline the difference with the digital one. By digitalization goods could initially be provided physically and this has subsequently been performed digitally.

Attention deserves also the issues regarding the Proposal referred by Garbarini (Garbarini, 2018). The author starts with comment on the general and probably the most essential question, whether the Proposal will be adopted unanimously by the Member States. If the answer is negative, further thorough analysis seems to be unnecessary. Another key point is what are the goals actually pursued – introduction of new rules or modification of the old ones. If the answer is the first option, this should be done with new provision, following the basic international postulates, rather than the introduction of new PE. Garbarini also raises the question whether there is difference between ‘significant digital presence’ and ‘significant economic presence’. These terms appear in some domestic legislations regarding the introduction of the new concept. If difference does not exist, only one term should be used to avoid possible ambiguity. If they differ, their purpose and scope should be carefully determined. Another issue is whether the ‘value creation principle’ is appropriate in the field of direct taxation, where ‘economic allegiance’ is commonly used. This may be seen in the League of Nations Model Tax Treaties from 1920, which also deals with ‘personal allegiance’ in relation to the taxpayer’s nationality or residence, including the PE’s idea (Schön, 2017). It is also necessary to analyse the Proposal’s effect on Brexit, as well as whether the examination of users’s number, as Proposal’s requirement, does not contradict the General Data Protection Regulation (GDPR).

Garbarini’s research raises crucial issues about the Proposal’s effectiveness, the in-depth analysis thereof may provide some guidance on this matter. This is another proof of how such mechanism is really appropriate.

### **III. Digital PE in some states and in Bulgaria**

Recognizing the digital economy’s significance as a major factor in the international relations, some states are seeking relevant solution for improvement of their domestic legislation on this matter.

For example, proposals have been made in the so-called Colin and Coli Report in France (Gaoua, 2014). There is also an idea to develop the PE’s concept via formula that includes sales, clients and selling agents in this state.

In connection with the current dynamic situation with COVID-19 pandemic Indonesia introduces the digital PE. It concerns the international service providers, as well as the international e-commerce platform providers whose activities are focused on Indonesian customers. Necessary condition is the exceeding of certain thresholds – gross revenues of the consolidated group, income from Indonesia, number of active users from Indonesia.

From Australian perspective, e-commerce business profits fall within the scope of Art. 5 of the concluded DTTs. I share Box's view that possible problems may be the determination of the website's fixation (Box, 2014). Another challenge would be the tax treatment of cloud computing.

Spanish Central Tax Court has already had the opportunity to analyze the digital PE's concept in 2012. The Irish company Dell Products Limited, part of Dell Computers Group, sells goods through a website in Spain. The Spanish company Dell Espana SA instructs its employees to translate the website in question, as well as other administrative activities in this regard. Despite the lack of physical presence for the Irish company, the court concludes that there is nexus that determines the PE's constitution. It relies on the Commentary and in particular the paragraphs on e-commerce to Art. 5 of the OECD-MC. On the one hand, even the mere existence of equipment does not automatically lead to PE. It may fall within the scope of Art. 5, para 4 of the OECD-MC. However, if it represents a significant and integral part of the company's activity, it may meet the requirements of Art. 5, para 1 of the OECD-MC. Therefore, PE can be fully automated without requiring of human presence in certain cases.

The question whether a server may constitute a PE finds an answer from Sweden's perspective. Companies X and Y are part of multinational group and they are residents of the same state. Company X performs technical, administrative and other types of services to the other group members, as there are no other external clients. In connection with the data center's establishment in Sweden, it buys server and rents premises. Company Y has fixed place at its disposal on the server, where it stores software that will be used by its Swedish clients. Company X receives share of the income of company Y as remuneration for the provision of server's place in question. Neither of the two companies has staff in Sweden and the server's maintenance and software will be carried out in another state. In this regard, question about the possible PE's constitution arises.

For this purpose, Monsenego makes an interesting analysis of the concept's essential requisites through the prism of the current factual background (Monsenego, 2014). First, he examines whether there is a specific place of business. He concludes that the server is characterized by its physical presence, i.e. it can be perceived objectively. I share his opinion that its size is

irrelevant. Another issue is who is the server's user – company X, company Y or both. Due to the lack of detailed information, the latter option is theoretically possible.

Analysis is also done on the server's fixation. Even if it is not stationary all the time, this does not automatically lead to PE's non-constitution. Another key point is the lack of staff. By explicitly Commentary's referral, the court concludes that this does not hinder the PE's constitution, based on the specific nature and the activity performed. Relevant criterion is whether it is preparatory or auxiliary one.

Monsenego is on the opinion that it is very challenging to determine to what extent fixation and permanence have been realized in this particular case. The question about the taxation of PE's business profits remains open, as there are no staff in this case and the risks or the assets can not be attributed by application of the so-called 'authorized OECD approach' in this connection.

Position on this issue can also be found in the Saudi Arabia's domestic legislation. It contains the so-called 'service PE', which is more broadly defined according to the criteria established by the OECD and the UN. Its constitution usually requires physical performance of the service in Saudi Arabia for a certain period of time. The state has also introduced the digital PE, which includes all days of the service, both inside and outside its territory, as required element. Necessary condition therefor is to be performed also by employees in Saudi Arabia at least 6 months (Gidirim, 2016). In this case, the existence of nexus regarding the employees' physical presence is not examined.

India introduces the concept of significant economic presence in the Finance Act 2018 in its domestic legislation, which expands the scope of the PE's concept. It covers cases such as the provision of data/software downloads when there is certain threshold of revenue generated. Another criterion is certain number of users by performance of systematic and continuous activities by means of digital devices. Although India uses the term economic presence and not the digital one, the idea is identical.

The concept of 'significant digital presence' was introduced in Israel in 2016. The main requirements for its constitution are significant number of Internet service contracts with Israeli users; services provided by the foreign enterprise to be used online by significant number of users or users in Israel; the foreign enterprise offers online services to Israeli consumers or users, such as through the use of Hebrew or Israeli currency, and others. The activities in question should not be considered as ancillary or preparatory.

Such rules do not exist and are still not envisaged in Bulgaria. The PE's definition in para 1, item 5 of the Additional Provisions of the Tax and

Social Security Procedure Code follows the OECD-MC's postulates in general. Letter 'c' thereof examines the cases when no DTT has been concluded.<sup>13</sup> Although at first glance it may lead any association with the digital PE due to the lack of requirement for fixed place or dependent agent, it pursues different aim. Permanent performance of commercial transactions is rather connected with the independent economic activity under VAT regime. Most likely, Bulgaria will follow the subsequent OECD's and EC's positions on this issue. Future reforms on this issue from worldwide and European perspective, as well as the practical cases, will provide guidance on the concept's development.

## Conclusion

PE is compromise on fair taxation between the resident state of the enterprise and the source state, where business profit is generated. I agree with Pistone and Hongler that despite the fact it resembles the VAT regime according certain criteria, the digital PE can not be defined as indirect tax (Hongler, Pistone, 2015). For example, taxation of income rather than taxation of consumption, its periodicity of collection, as well as the irrelevance of whether an invoice has been issued or not, are relevant arguments for such view.

A welcoming idea is the introduction of separate threshold for each state that leads to digital PE's constitution based on specific formula (Ponomareva, 2019). Considering the digital economy's nature, it should be estimated to what extent it really differs from the normal economy (Reuven, 2013).

Digital PE's introduction will determine the need for DTTs modifications in this regard, which will most likely lead to threshold's amendments for PE's constitution. It will also reflect the rethinking of the international tax law postulates. In this regard, I support Schön's view that the old principles should not lose their significance. This would likely lead to additional administrative burdens. It is also noteworthy to estimate how it will reflect on the activities that do not constitute a PE.

Problems may also arise in the event of simultaneous constitution of two PEs and more specific in which cases the traditional PE's concept applies and in which – the new digital PE. Disputable is the treatment of these activities, which are combination of both digital and physical presence

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<sup>13</sup> Para 1, item 5, l. 'c' of the AD of the TTSPC: 'sustained effecting of commercial transactions with a place of performance inside the country, even where the non-resident person has no permanent representative or fixed base'.

(Olbert, Spengel, 2017). This respectively may lead to double taxation due to the inability of business profit's attribution.

PE is in direct relation with the fixed establishment's concept under VAT. Therefore, it is necessary to estimate whether the digital PE's introduction will also reflect the legal nature of the latter.

Other issues may arise regarding the DTTs. It is debatable whether the possible introduction of new provision, which will be a new direct tax, falls within the scope of Art. 2 of the OECD-MC. An example is the German trade tax that is a direct tax under the domestic law and it falls within the scope of the above mentioned provision. Taking into account the terms under Art. 3 of the OECD-MC, another possible question may be regarding the extension of 'business' definition in relation with the digital economy or even to create a separate one. Another suggestion is new Art. 7A of the OECD-MC, which specifically addresses the digital PE's taxation.

Based on the PE concept and the idea for fair taxation of the digital economy, I consider the digital PE's introduction to be rather outdated, inefficient and risky. As already stated above, digital PE would reflect other DTT's provisions, DTT's renegotiation, changes in the domestic legislation and in the established traditional principles in the international tax law.

That is why I believe that the most rational option at this stage is to separate digital services in a new, independent provision, similar to the UN's position on this issue. Therein both their legal nature and the way of taxation may be outlined.

Even the idea of digital PE will be followed as the only rational measure, the following aspects should be seriously considered – how this will reflect on the Commentary, on Art. 5 and on Art. 7 of the OECD-MC, on the European and on the international tax law. Despite the complexity of this matter, a suitable option, which can be subsequently modified by necessity and be a guarantee for fair and equal tax treatment, should be found.

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