Taxing digital economy in 2018 through non-tax compliance ?

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Introduction

1. On 5 December 2017 the Council of the European Union adopted several decisions[1] of which two relate to taxing digital activities.

The conclusions on taxation of the digital economy[2] will serve in the Council's view both as the EU's contribution to discussions at international level and as a reference for further work at EU level. The text highlights the urgency of agreeing on a policy response at international level, and calls for close cooperation with the OECD and other international partners. It suggests that a concept of 'virtual permanent establishment' be explored, together with amendments to the rules on transfer pricing and profit attribution.

New VAT rules on electronic commerce[3] are part of the EU's 'digital single market' strategy of the Council. A draft of a directive and two regulations were approved[4]. These proposals are aimed at facilitating the collection of VAT for goods and services bought online, including from third countries.

The European Commission launched a public inquiry on taxing digital economy on 26 October 2017[5]. The period of that public inquiry ended on 3 January 2018.

2. The OECD launched a public inquiry on taxing digital economy in October 2017. In a window of only a couple of weeks, over 500 pages were collected[6].

On 27 November 2017 the OECD published[7] a new version of the OECD tax treaty model. This following the OECD Council's decision of 21 November 2017.

Among various points, new comments have been inserted that relate to Article 5 of the OECD Tax model (permanent establishment) following the OECD's Action 7, final report of 2015 on Preventing the Artificial Avoidance of Permanent Establishment Status[8].

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1 http://www.consilium.europa.eu/media/31950/st15305en17.pdf

2 http://www.consilium.europa.eu/media/31933/st15175en17.pdf

3 http://www.consilium.europa.eu/en/press/press-releases/2017/12/05/vat-on-electronic-commerce-new-rules-adopted/

4 http://www.consilium.europa.eu/media/31929/st14126en17.pdf
http://www.consilium.europa.eu/media/31930/st14127en17.pdf
http://www.consilium.europa.eu/media/31931/st14128en17.pdf

5 http://europa.eu/rapid/press-release_IP-17-4204_en.htm ; see also the further links on that page

6 OECD, *Tax Challenges of Digitalisation. Comments received on the Request for Input – Parts I & II*, 25 October 2017

7 http://www.oecd.org/tax/treaties/oecd-approves-2017-update-model-tax-convention.htm

8 see the OECD website, under 'topics'

3. Countries like India or Italy have already adopted or are in the phase of adopting legislation that taxes some specific digital activities.

4. These recent actions have already given cause to reactions outside the European Union. Following these reactions changes by 'virtual Permanent Establishment' cannot be unilaterally implemented by the European Union or any given country without first adopting a new definition of Permanent Establishment by the OECD Council.

Also, such a new definition could only apply to future tax treaties and not affect the existing tax treaties without a specific addendum approved by both contracting countries. It can be predicted with a degree of near certainty that some of the aimed digital activities will be based in countries that linger in approving such addendums.

All taxation that uses an extensive reading of Article 5 of the OECD tax treaty through a non-physical presence criterion for Permanent Establishment could give cause to tax litigation by invoking the violation of the rights granted under existing tax treaties.

This question will remain highly relevant in the author's opinion in the coming years while awaiting the implementation of new definitions through addendums in the existing tax treaties.

5. The scope of this article is to seek how such litigations may be avoided through non-tax law compliance. This article does therefore not analyse or comment the on-going efforts in both the OECD and the European Union in taxing digital economy.

The article first of all analyses what possible digital activities could give cause for new criteria of Permanent Establishment for taxation purposes.

After identifying these tax bases, it will examine to what extent European legislation and national legislation could adopt in 2018 measures that directly or indirectly lead to taxation on digital activities under the existing tax treaty models while awaiting the addendums on the existing tax treaties.

In the last section of the article, the author analyses non-tax Union law that could impose a minimal physical presence for some digital activities. This presence could then qualify as a Permanent Establishment under the definition of the existing tax treaties.

I. How to define digital activities for tax purposes ?

6. Next to the extensive report filed in October 2015 by the OECD that addresses avoidance of Permanent Establishment criteria in general under Article 5 of the OECD's tax treaty model, a more specific action was undertaken towards taxing digital economy.

The OECD launched a two-week **public inquiry on taxing digital economy** [9] in October 2017. The reporting participants can be roughly divided into three groups of stakeholders :

- Digital companies (Blablacars, Spotify) and companies who have developed significant digital activities (Sony),
- Intermediaries (banks, certified/chartered accountants, tax-lawyers, tax-consultants),
- Civil society (professors, tax justice groups and individuals).

7. Digital companies invoked their positive impact on overall growth and innovation for questioning the need of taxing their activities by other means than the existing rules. They seem to fear excessive taxes and double taxations.

The company with large digital activities (Sony) invoked that technology and competition have forced them to switch their business model to downloadable content through accounts, rather than material carriers of music through shops. This company requests that criterions of taxation should not lead to a new increase of tax compliance burdens.

8. The bulk of the intermediaries questioned the possibility to distinguish clear criteria between a digital and a non-digital company.

They generally express fear for arbitrary taxation that hamper growth or indicated that no taxation (withholding tax, equalization levy, transaction tax) is possible without violating various rules and tax treaties.

Dutch tax lawyers[10] resumed these concerns in concise terms :

> "*The apparent consensus is that profits should be taxed in the jurisdiction in which value creation occurs. The difficult question is how to determine where value is created*."
>
> "*Based on the above, we come to the conclusion that it will be very difficult from a corporate tax point of view to treat the digital economy separately or differently from the rest of the economy in a world that is becoming increasingly digitalized*."
>
> "*If we cannot separate digital from non-digital, we should perhaps not even try*."

[9] OECD, *Tax Challenges of Digitalisation. Comments received on the Request for Input – Parts I & II*, 25 October 2017

[10] OECD, *o.c.*, Part II, Loyens & Loeff Amsterdam, 13 October 2017, p. 134 – 143

9. Whereas Milanese tax lawyers[11] see the unfolding technology of clouds as an ultimate shift from territorial tax criteria of production towards territorial tax criteria of consumption.

They also indicate that the users' data, which is collected by providers, is used for various commercial purposes. This personal data has an important economic value.

These participants propose to apply the definition of Permanent Establishments under Article 5, § 2, (f) OECD MC (any other place of extraction of natural resources) for personal users' data as extracted in the territory of the State the users reside in. They further suggest the tool of a world level profit split of the group the provider belongs to calculate the profit tax base of the data collected of these users.

10. It is however in the author's view strongly debatable if Article 5, § 2 (f) OECD MC could apply on digital activities without at least the physical location in the Member state of one or more servers or terminals that access those servers in an office of that provider based in the territory of that State.

In general, an economy of goods offered clear criteria where and how the value was created. In economies where services became the main contributor to wealth, the same criteria were more or less maintained for as long as the client had to come to the offices where the services were made available to him.

Digitalization makes it increasingly difficult to maintain territorial production criteria and leads to serious tax distortions under the obsolete profit base criteria.

Other economical entities, potentially worldwide based, are willing to pay for publicity these users see or for the data, containing the users' preferences, for marketing purposes. It is therefore logic to adapt the tax system in general to this new reality.

The Milanese tax lawyers propose to consider software, hardware and most of all – indirectly – humans, as a new sort of natural resource. But if one reads Article 5 OECD MC as a whole, this is a highly questionable view with regard to the contracting parties intent when they agreed on Article 5, § 2 (f) OECD MC.

The author nevertheless found it to be an interesting view that triggered his search if criteria other than Article 5, § 2 (f) OECD MC could be less debatable through various non-tax compliance requirements.

11. The third group of stakeholders to the OECD public enquiry consists of civil society participants. They express their concerns in general ways on the problem of income tax base and profit tax base distortions through activities that are hard to locate and to economically quantify.

A participating group[12] stated a paradigm shift in international tax is needed :

[11] OECD, *o.c.*, Part II, Ludovici Piconne & Partners, p. 144 - 150
[12] OECD, *o.c.*, Part I, The BEPS Monitoring Group, p. 20

"The main changes due to digitalization are

(i) the closer relationship it both requires and enables between producers and consumers;
(ii) the digital services that are often supplied with no direct charge to users, while their inputs are monetized through revenue generated through services provided to other customers, especially advertising; and
(iii) the ability that digitalization gives for some firms to recharacterise themselves as pure intermediaries between producers and consumers."

While awaiting this shift in international tax, this participant group pleads for temporary tax measures to address distortions without further waiting. Other participants [13] suggest reviewing permanent establishment definitions and use the issuers of credit cards for the purpose of collecting a withholding tax on payments through these cards.

12. A possible definition of **digital economy** can be considered as formed by all activities that allow creating value through digital means. They relate to users, goods and services in general and even trading in particular. Classic criteria of goods and services do not suffice to value the wealth created by the digital economy[14].

Technical innovations over the past decades have set in motion a considerable reduction of the costs for clients to access companies wherever they are located in the world and have increased the types of services that can be offered by these companies.

A company that mainly communicates with the bulk of its national clients through digital means such as websites, mails or call-centres should be considered subject to digital tax measures when a given % of orders is dealt through exclusive digital tools. Even if this company supplies goods to consumers, such as gas, electricity or water. Even if it is a bank that offers applications on smartphones that no longer needs human interfaces for trading on the stock market or all sorts of internet banking.

Free users and their collected data represent an increasingly important economic value for advertising and marketing that pose problems in terms of determining the size and allocation of their created wealth. The data collected from paying users can be considered of even higher relevance for advertising and marketing purposes, and should as such give cause to an even higher economical value of these data.

13. Tax distortions are more easily organised in a digital economy. They relate to :

- Income *originated* in the Member State from a digital activity *offered* in that Member State, is taxed differently if that income is not *collected* inside but outside the

[13] OECD, o.c., Part II, Prof. Saturnina Moreno and M. José Ángel Gómez, 12 October 2017, p. 275 - 278

[14] OCDE, Tax Challenges of Digitalisation, Comments Received on the Requests for Input – Part II, 25 October 2017, contributions of Prof. Dr. Christoph Spengel, Ann-Catherin Werner and Marcel Olbert, p. 305, point A.3 with reference to footnote 9, point C.2 and D for various other tax suggestions

Member State.

The originated profit tax base is delocalized by allocation of the collecting of income.

- Even when all *originated* income is *collected* through a company or a Permanent Establishment in the Member State, allocating a part of the *offered* digital activity outside the Member State gives cause to annihilate or substantially reduce the profit tax base formed by that collected income.

This eroding of the profit tax base originated in the Member State is triggered by allocation of the digital activity outside the Member State.

Both types of dislocations can occur in the same business model and reinforce each other's effects on preventing taxation in the Member State where the profit tax base is originated.

14. A possible relevant definition for **digital companies** relates to all companies that mainly or exclusively operate digitally in their contact with clients. Their main resource is data and data processing of its clients. They are different from other companies with digital activities that also need physical storage for goods or tools.

Their working costs allow an easy start-up. It basically suffices to have an access to the Internet and a server and to scale the server up as the number of users or clients grow. Such companies can be easily transferred or reorganised for tax engineering purposes.

15. The smaller the digital company, the higher the relative cost for tax compliance for doing business outside the Member State it is based in. The digital company has to compete with larger competitors, both inside and outside the Member State, that effectively suffer lesser corporate income taxes through tax engineering.

If competition is fierce in price setting, equally sized digital companies located in Member States with lower corporate tax rate and profit tax base, have a higher competition advantage in offering their services at a lower cost.

This creates a distortion of the Integrated market and can force companies to incorporate themselves in the Member State with a lesser tax rate or base in order to create an advantage over their competitors in other Member States or to neutralize that advantage.

16. A possible definition for **relevant digital activities** are business models with increased risks of tax distortion through optimization of allocation of digital activities and/or income :

- Companies that offer both free and paying digital services to **users**.
- Companies that sell **goods for the digital economy would typically include high percentages of royalties or patent rights in their price** or **mainly offer goods through digital activities**.
- Companies that **mainly offer services through digital activities** form the fourth business model. **Digital trading and web-based tools of payment activities** form a sub category of that business model.

II. Taxing tools of relevant digital activities.

17. The main issue in taxing digital activities is the technical easiness for providers in dislocating activity (offered) or income (collection) from the country where the profit tax base is economically triggered (originated).

As said above, the criteria for Permanent Establishments stipulated in existing tax treaties do not allow to allocate digital activities that don't have a minimal form of physical presence in the country where the profit is originated.

Without Permanent Establishments, such activities escape various measures that seek to amend tax engineering that reduces the profit tax base. The lack of a Permanent Establishment will result in these tax measures not applying to such activities.

18. Under **European direct tax rules**, no definition of digital economy, digital companies or relevant digital activities exists. Taxation of corporate income is a competence that remained with the Member States. The considerations[15] of the Council Directive (EU) 2016/116 of 12 July 2016, laying down rules against tax avoidance practices that directly affect the functioning of the internal market, point in general at the necessity of anti-avoidance measures to apply equally to resident, non-resident and third country competitors.

CFC measures also best reduce tax compliance burdens by exempting entities with low profits or low profit margin for they give less cause to tax avoidance.

Direct tax definitions of digital companies or digital activities best apply these two considerations to avoid tax litigation by companies that consider themselves unfairly taxed where other national competitors are not or less taxed.

The Member States have to implement this Directive by **December 31st 2018**. However, to be effective, it requires an established company or a Permanent Establishment in the Member State[16]. This Directive and its national implementations are therefor useful for that group of digital activities that meet the existing tax law requirements of Permanent Establishments.

By adopting non-tax law requirements of presence to all competitors that seek to exert a same size and type of digital activity, but that fall out of the scope of the Directive by lack of a Permanent Establishment in a Member State, the scope of the Directive and its national implementation could be considerably widened. These non-tax law requirements of presence would then in turn trigger the tax law requirements of presence for Permanent Establishment purposes.

19. Under **European indirect tax rules**, some relevant digital activities presently qualify as telecommunication services or electronically supplied services. They allocate at the seat of

[15] considerations 11 and 12

[16] Article 1 : This Directive applies to all taxpayers that are subject to corporate tax in one or more Member States, including permanent establishments in one or more Member States of entities resident for tax purposes in a third country.

the professional client (non-consumers)[17]. Article 24 defines services under this Directive as '*any transaction which does not constitute a supply of goods*'. All relevant digital activities not relating to goods are taxable services.

It is also relevant to note that Article 24 defines 'telecommunication services' as :

> *"services relating to the transmission, emission or reception of signals, words, images and sounds or information of any nature by wire, radio, optical or other electro-magnetic systems, including the related transfer or assignment of the right to use capacity for such transmission, emission or reception, with the inclusion of the provision of access to global information networks*"

Article 56, 1, (k) refers in turn to electronically supplied services that are defined in annex II of the Directive as :

(1) Website supply, web-hosting, distance maintenance of programmes and equipment;
(2) supply of software and updating thereof;
(3) supply of images, text and information and making databases available;
(4) supply of music, films and games, including games of chance and gambling games, and of political, cultural, artistic, sporting, scientific and entertainment broadcasts and events;
(5) supply of distance teaching.

It is clear that a substantial part of the relevant digital activities can qualify under this more specific definition of electronically supplied services.

20. The difference between telecommunication services and specific electronically supplied services relates to the place where the VAT transaction is deemed to happen.

Article 56 states that if these services are provided towards consumers *outside* the European Union (Community) or from one taxable person to another taxable person *inside* the European Union (Community) in another country, the place of the service is the address or seat of that taxable person or its fixed establishment (the client).

In order to prevent double taxation, non-taxation or tax distortion Member States can decide that telecommunication services, when offered *from outside* the European Union (Community) to *a taxable person*, are considered to take place in the seat of the taxable person or its permanent establishment (Article 57 TFUE).

This rule does not apply to electronically supplied services *from outside* the European Union (Community) to non-taxable persons (consumers) ; at present, these types of services provided from *outside* the European Union cannot be located in the European Union (Community) by the Member States for present VAT purposes.

[17] Articles 56 and 58 of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

Under the present law a substantial part of relevant digital activities escapes VAT rules on electronically supplied services to non-taxable persons.

21. As stated above, the Council of the European Union decided on 5 December 2017 to review VAT rules[18] and a proposal of Directive and two Regulations on electronic commerce are in process of adoption.

Coming into effect on **January 1st 2019** article 58 of the VAT Directive is to be modified and states that for both telecommunication services and electronically supplied services to non-taxable persons the service is considered to take place where that person lives.

Coming into effect on **January 1st 2021** articles 58 and 59 c of the Directive are to be modified and will state that both goods and all services that involve their shipment are considered to take place where they are delivered.

If the seller of these goods is not established or has no fixed base in the European Union, the new article 369p will obligate that seller and the intermediary appointed by the seller to, prior to the shipment into the European Union (Community), declare :

(a) name;
(b) postal address;
(c) electronic address and websites (of the seller);
(d) VAT identification number or national tax number.

Records must be kept by both the intermediary and the provider for control purposes. The consideration (8) of the VAT Directive reminds that '*Where the records consist of personal data, they should comply with Union law on data protection.*'.

The VAT Directive seems to concern all relevant digital activities in goods and paying services that don't have a fixed base in the European Union and thus more effectively addresses indirect tax purposes dislocation through activity (offering) or income (collecting).

22. For **Member State direct tax purposes** they remain competent in taxing profit through relevant digital activities. Next to their tax treaty obligations, Union law also imposes requirements to Member States for that direct taxing purpose.

It is not debated in the present state of the European Union law[19] that each Member State can tax sovereignly in the matter of national or regional corporate tax rates and bases, if done so - in substance - by not hampering the Internal Market and the existing common decisions in indirect tax matters.

[18] http://www.consilium.europa.eu/en/press/press-releases/2017/12/05/vat-on-electronic-commerce-new-rules-adopted/

[19] The impact of the rulings of the European Court of Justice in the area of direct taxation 2010, European Parliament's Committee on Economic and Monetary Affairs, ref. online IP/A/ECON/ST/2010-18

The power of Member States in direct taxation is so indirectly limited by their general obligations (freedoms of the Internal Market, Council Directives, Tax Treaties, constitution) and their obligations under indirect taxation.

If Article 4 TEU gives free reign to the Member States to act sovereignly, with respect for the treaty's obligations, then this is not the case for the Commission. The Commission has no power in direct taxation.

Initiatives in direct taxation must be embedded under Article 5 TEU, which leaves the Council as the authority to decide on these measures and the Commission to suggest and execute them.

23. With regard to **the freedoms that are guaranteed by the TEU and TFEU under the Internal Market**, the freedom of services is qualified by Article 57 TFEU as those services that are *normally provided for remuneration* and are not governed by the provisions relating to freedom of movements of the other three freedoms (goods, capital and persons).

How does this affect the power of direct taxation of Member States with regard to users of digital services with free access, such as websites (Google, yahoo,..) and networks (Facebook, Twitter, LinkedIn,..) ?

The logical deduction would be that free digital services are not protected under the provisions of the Internal Market that relate to services. Member States could argue that they can adopt direct tax measures that distort the market of such free digital services. Such national legislation should however be very careful not to discriminate or to indirectly violate other Union laws.

24. Article 65 TFEU allows Member States to adopt unilaterally restrictive tax measures towards both Member States and third countries that can hamper the free movement of capital and payments. No such provision exists for the other three freedoms under the Treaty.

Article 65 (1) b empowers Member States to :

> *"take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation (..)"*

Arbitrary discrimination or disguised restrictions on the free movement of capital and payments are forbidden (Article 65 (3)).

25. Article 292 TFEU, combined with Article 65 (4) TFEU, could provide the Commission with a legal base for guidelines on direct taxation with regard to third countries.

Article 65 (4) TFEU empowers the commission to state that restrictive tax measures related to third countries that violate the interdiction of restrictions on free movement of capital and payments, are compatible with the European Union law, as far as they are justified by one of the objectives of the Union and compatible with the proper functioning of the Internal market.

This is a specific power of the Commission that may qualify under Article 292 TFEU.

While not being compulsory for the Member State, such references by guidelines and considerations may increase the chance to uphold their unilateral digital tax measures before the Court of Justice of the European Union[20].

26. In a ruling of 13 November 2014 the tax criteria for Member States under Article 65 (3) TFEU or *'by overriding reasons in the public interest as defined in the Court's case-law*' were once more confirmed[21] by the Court of Justice of the European Union.

Directive 2006/123 of 12 December 2006 on services in the internal market[22] defines under Article 4 (8) the notion of 'overriding reasons of public interest' as :

> *"means reasons recognised as such in the case law of the Court of Justice, including the following grounds: public policy; public security; public safety; public health; preserving the financial equilibrium of the social security system; the protection of consumers, recipients of services and workers; fairness of trade transactions; combating fraud; the protection of the environment and the urban environment; the health of animals; intellectual property; the conservation of the national historic and artistic heritage; social policy objectives and cultural policy objectives;"*

The following general criteria must be observed by the tax law of Member States :

- an objective justification for the restriction by legitimate interest recognised by the law of the European Union,

Such objective justification can be used to target '*wholly artificial arrangements which do not reflect economic reality and whose sole purpose is to avoid the tax normally payable on the profits generated by activities carried out on national territory*'.

Such objective justification can be to '*safeguard the allocation between the Member States of the power to impose taxes*' [23].

- the restriction must be appropriate to the objectives of combating tax evasion and tax avoidance and not go beyond what is necessary to attain them.

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[20] The impact of the rulings of the European Court of Justice in the area of direct taxation 2010, European Parliament's Committee on Economic and Monetary Affairs, ref. online IP/A/ECON/ST/2010-18, p. 7 (introduction) and references under footnote 1

[21] Court of Justice of the European Union, Commission c Great Britan and Ireland, 13 November 2014, C- 112/14, with reference to *Commission* v *Germany*, 23 October 2007, C-112/05, § 72, *Commission* v *Portugal*, 7 April 2011, C-20/09, §§ 59, 60 – 61, *Itelcar*, C-282/12, §§ 34 and 36

[22] DIRECTIVE 2006/123/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCI of 12 December 2006 on services in the internal market, OJ, L 376, 27 December 2006, p. 36

[23] Court of Justice of the European Union, *SIAT*, 5 July 2012, C-318/10, § 37

Such an appropriate restriction allows the taxpayer to prove that there is a commercial justification for that transaction without subjecting the taxpayer to undue administrative constraints in giving this proof.

Such appropriate restriction is confined to the part that exceeds what would have been agreed on an arm's length basis between parties[24].

Such appropriate restriction also requires in more general terms[25] :

> '*the principle of legal certainty, in accordance with which rules of law must be clear, precise and predictable as regards their effects, in particular where they may have unfavourable consequences for individuals and undertakings'.*

27. In the contribution of the International Observatory on the taxation of the Digital Economy (University of Lausanne, International Bureau of Tax Documentation, KU Leuven) to the OECD public enquiry on taxing digital economy[26] a direct tax under the form of a withholding tax charged on some digital activities is proposed as compatible with Union law.

The authors of that contribution also insist on the need to apply the same tax base for all companies that offer the same or comparable digital activities, in order to avoid discriminations and new tax distortions.

28. With regard to a **Member State's obligations under indirect taxation**, Article 401 of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax states :

> *"Without prejudice to other provisions of Community law, this Directive shall not prevent a Member State from maintaining or introducing taxes on insurance contracts, taxes on betting and gambling, excise duties, stamp duties or, more generally, any taxes, duties or charges which cannot be characterised as turnover taxes, provided that the collecting of those taxes, duties or charges does not give rise, in trade between Member States, to formalities connected with the crossing of frontiers."*

This Article prohibits any other tax on products and services that constitutes a turnover tax or is triggered by the crossing of frontiers between Member States. Formal direct taxes may so qualify as prohibited indirect taxes if the following effects occur[27] :

- it applies generally to transactions relating to goods or services;
- it is proportional to the price charged by the taxable person in return for the goods

[24] Court of Justice of the European Union, *Itelcar*, C-282/12, § 36 with reference to *Test Claimants in the Thin Cap Group Litigation*, 13 March 2007, C-524/04, § 83 ; SIAT, 5 July 2012, C-318/10, § 52

[25] Court of Justice of the European Union, SIAT, 5 July 2012, C-318/10, § 58

[26] OCDE, Tax Challenges of Digitalisation, Comments Received on the Requests for Input – Part II, 25 October 2017, contribution of the International Observatory on the taxation of the Digital Economy, p. 279, points 11, 19, 21 to 24

[27] Court of Justice of the European Union, Banca popolare di Cremona Soc. coop, 3 October 2006, C-475/03, § 30

and services which he has supplied;
- it is charged at each stage of the production and distribution process, including that of retail sale, irrespective of the number of transactions which have previously taken place;
- the amounts paid during the preceding stages of the process are deducted from the tax payable by a taxable person, with the result that the tax applies, at any given stage, only to the value added at that stage and the final burden of the tax rests ultimately on the consumer.

Direct taxes on digital activities must respect these specific interdictions without possible exception. A Danish tax of 2,5 % for financing employment measures calculated on the turnover of VAT taxable companies or on the total of paid salaries for other companies qualified under this prohibition for the part of the tax that concerned the turnover tax base[28].

29. An Italian regional tax that constituted a,

(a) non-deductible direct income tax of 4,25 %,
(b) on productive activities of services and goods in general,
(c) that is perceived on a fictional tax base of net-value determined by type of activity,
(d) and that refers to income tax base criteria,

was not considered by the Court of Justice of the European Union as a prohibited turnover tax[29].

The key elements throughout the Court's ruling in that case was the presence of two elements :

a) a fictional tax base that targets a part of the taxable profit under corporate law that was obtained with collected income (§§ 31 and 33),

b) the non-deductible character of the tax from corporate income tax, preventing its passing on to other economical agents and making it uncertain if the final consumer will suffer this tax in the price he pays (§§ 31 and 34).

30. Having analysed the general frame in which Member States could adopt direct tax measures with regard to relevant digital activities, it is further relevant to define in their business models the need or lack of physical presence in the place where the profit tax base is originated.

The smaller that need, the more relevant is will be to consider adopting non-tax law requirements that impose a physical presence where such profit tax base is originated.

[28] Court of Justice of the European Union, Commission v. Denmark, 1 December 1991, C- 324/91.
[29] Court of Justice of the European Union, Banca popolare di Cremona Soc. coop, 3 October 2006, C- 475/03, §§ 5 - 11 and §§ 31 - 34

All comparable business models should best suffer a same tax regime[30].

To that end, the following business models can be defined :

1) Free users and services.

31. This business model relates to all companies that are mainly interested **in the worldwide merchandising (1) of the users of their websites and the data collected from them (2)**. **In order to improve collecting this data they offer their users free access to data or services (3)**.

Under Article 16 TFEU the protection of personal data is a part of the European Union law. Companies subject to European data protection compliance are most eligible to be included in this group.

32. For means of taxing business models the likes of **Google, Facebook, Twitter, Skype** or more in general **all forms of free access (1) through digital interfaces (2) to digital information or communication (3) with a commercial intent for the provider (4)**, three steps seem logical to determine a realistic assumption of a profit tax base created by the worldwide commercialising of the number of users or their collected data obtained inside a Member State or the European Union :

a) determine the number of users in the European Union for a given period (or in the Member State) in the worldwide number of users of a commercial group that reports worldwide income to its shareholders that is substantially obtained from merchandising users and data collected from users,

b) the GPD per capita of the European Union (or the Member State) is multiplied with the number of users in the European Union (or the Member State), and so are the nationals GPD's per capita of the worldwide users, and the compared result is represented as a percentage,

c) that percentage is multiplied with the reported worldwide cash flow and gives the gross profit tax base that is assumed to be allocated in the European Union (or the Member State).

33. Such assumed gross profit tax base is clearly oversized for it does not take into account worldwide expenses and will lead to excessive taxation if not adjusted by ways of a profit margin.

This profit margin gives the assumed net profit tax base and is best fixed as a low profit margin.

[30] The impact of the rulings of the European Court of Justice in the area of direct taxation 2010, European Parliament's Committee on Economic and Monetary Affairs, ref. online IP/A/ECON/ST/2010-18, §§ 157, 167 – 170 and 175.

For tax compliance burden purposes it would be preferable that the allocated worldwide income is determined on a European level as a whole. The European Commission could so levy European taxes on that worldwide income obtained from users located in the European Union. That own income for the Commission can be used in turn to address the impact of Brexit on the European budget or to reduce, to some extent, the rising contributions of Member States to the European budget for urgent challenges such as defence, border control or immigration.

34. If these companies have no Permanent Establishment present by choice, a direct tax measure that seeks to create a virtual Permanent Establishment would violate the tax treaty rights of these companies.

In the third section of the article the question is examined if through non-tax requirements such as data protection, criminal investigation, fake news containment,.. a physical presence can be demanded from all companies that have such a business model. These requirements of presence may in turn give cause to a Permanent Establishment criterion.

2) Paying users.

35. This business model referrers to paying websites such as **Netflix**, **or in general all access offered through digital interfaces (1) to digital information or communication (2) that requires payment (3)**. Various information sites such as newspapers websites, television-channels on web,.. have this business model.

Companies with this type of business model are taxed by classic means on the collected fees of the paying users in the Member State. But allocation tools of collecting income can hamper the profit tax base for the Member State where these paying users reside.

Paying users, like free users, also give cause to data mining and advertising all over the world. So the cash flow that is obtained from advertising, or data mining related to users, should be determined in the overall income.

Free business models could be tempted to avoid taxes by rather symbolic subscription fees. Some business models mix both free and paying users.

36. The first allocation problem is the allocation of collecting the fees of the users.

Delocalization of collecting income can be addressed by *recipient* reports to the Member State of fee payments originating from that Member State. Such tax law obligation would also require a Permanent Establishment.

37. The second allocation problem is the allocation of the digital service itself outside the Member State in order to reduce or annihilate the profit tax base on fees collected in the Member State. This problem relates to BEPS and CFC regulation for those providers who have a Permanent Establishment.

The companies that don't have a Permanent Establishment may be subjected to the same non-tax requirements as the business model of free users and services (see hereinafter section III).

3) Digitally sold goods and material digital interfaces,

38. Music, movies, books and clothes are in large numbers ordered through websites. But the producers of goods frequently have websites themselves where they propose to sell and ship directly to the client.

So the criterion of ordering goods through digital interfaces is far too wide to constitute a relevant digital activity.

39. Some companies like **Apple** are manufacturing products that can be described as the digital interfaces themselves. These goods form a substantial part of digital economy for they form the tools of connectivity.

Such goods would include cell phones, tablets, computers, screens and touchscreens but also the software needed to operate these digital interfaces.

The production costs of such goods are typically far less expensive than their selling price. These digital interfaces are under patent rights that take up a substantial part of their selling price that largely exceeds the historical development cost. Such rights dislocate substantial parts of the profit tax base in the Member State where the sale and payment of the price occurred.

40. But if all companies that sell such goods were to be included, a company that sells all kinds of electronic equipment could also be included. Even very small companies who do not necessary have the means to proceed to any tax engineering whatsoever.

And global players such as **Amazon** would only be taxed on that segment of their turnover represented by such goods. This business model covers buying and reselling goods through digital interfaces, digital communications and digital payment. Again, a substantial part of the profit tax base originated through the sale and payment in the Member State, is dislocated through payment of rights to use the website.

41. Given these general considerations, a business model criterion for direct taxes in digitally selling goods could be defined as **goods sold in the Member State (A) which include in their price a substantial cost of rights (a 1) or rights calculated on the profits / turnover made by selling these goods (a 2) which are payable to companies of the group, the company or the Permanent Establishment (a 3), or sold in the Member State (B) by orders received through internet or call-centres (b 1) when a minimum lump sum cash flow (*) is originated from the Member State (b 2)**.

(*) the criteria mentioned in Council Directive (EU) 2016/116 of 12 July 2016, could serve as a minimum reference

This definition includes both business models like **Apple** or **Amazon**.

42. Selling goods normally requires facilities on the territory of the Member State. Most companies that fall under these business models' criteria also fall under existing Permanent Establishment's criteria.

These business models are best addressed through BEPS, CFC's and specific tax measures that comply with the requirements of article 65 (3) of the TFUE or the case-law of 'overriding reasons of public interest'.

Ordering and shipping goods that fall under this business model, from outside the Member State or the European Union, and that give no cause for location criteria under OECD criteria, would best be addressed by indirect tax tools.

These business models are therefore not considered for establishing a Permanent Establishment by non-tax law requirements.

4) Paid digital services,

43. This business model can be described as **offering or organising services in the Member State (1) as an intermediary or directly (2) through digital interfaces (3) and in exchange of payment (4)**.

Call centres or web-based paying services can be set up all over the globe without requiring physical contact with clients. Risks of dislocation of collecting income and parts of the digital service are generally high in this business model.

44. The combined criteria 1 (offering or organising services in the Member State) & 3 (through digital interfaces) exclude services that are generally not conducted by digital interfaces.

They require in general a meeting in person with the client (doctors, lawyers, architects,..). This exclusion would only apply to the direct providers of these services, and not to digital intermediaries.

45. The combined criteria 2 (qualifying the intermediary under the same requirements as a direct provider) & 4 (reporting (electronic) payments originating in the Member State) typically serve CFC / BEPS purposes in this business model to create / preserve a profit tax base where it originated.

Delocalization of collecting income can also be addressed by *recipient* reports to the Member State of electronic payments originating from that Member State. This direct tax law requirement needs at least a Permanent Establishment.

46. If no presence qualifies as a Permanent Establishment under OECD criteria, this business model could easily continue to elude allocation of profit tax base.

By defining under national law that all national legal requirements for national based providers of such services in the territory of the Member State also apply to the company that collects the income from such services when that company is established in another Member State. These national requirements would then generally lead to a criterion of localisation under OECD rules for Permanent Establishment purposes.

47. This relates to a business model like **Uber**. Uber clients in Europe pay to a bank account in the Netherlands belonging to a company incorporated in that country, from that bank account a % is sent back to the national provider of the service. The % that remains is affected through tax engineering to a tax rate of 0 % on royalties in the Netherlands.

This model creates a tax distortion with other suppliers of passenger transport, who are taxed on the full price of the service they provide in the Member State. Basically, the full cost of the service is carried out in the Member State and the profit is split between the provider of the Service and the digital intermediary.

The tax distortion is the loss of corporate income tax on that part of the profit which Uber collects outside the Member State. Through this distortion, they can offer lower prices to the clients than their competitors.

48. In a ruling of 20 December 2017, the Court of Justice of the European Union qualified the business model of Uber[31] as that of a provider of services (§ 39) :

- the selection of non-professional drivers using their own vehicle, in an application without which (i) those drivers would not be led to provide transport services, and (ii) persons would not use them,
- decisive influence over (i) the maximum fare by means of the eponymous application, that the company receives that amount from the client before paying part of it to the non-professional driver of the vehicle, and (ii) the quality of the vehicles, the drivers and their conduct, which can, in some circumstances, result in their exclusion.

Even if in this case it can be assumed that Uber already had a Permanent Establishment through its Spanish company, this ruling forms a precedent for Member States that wish to zoom into various digital activities where the digital intermediary has no Permanent Establishment, but a substantial role in the collecting of the income and the conditions of the service that takes place on the territory of the Member State. Under the scope of the same requirements others providers of these services have to comply with, a Permanent base could then be triggered for tax purposes.

5) Traders and web-based tools of payment providers.

49. Providers of digital trading or digital payment services fall under the general business model of digital services. **E-Bay** qualifies as such a business model but also stock market traders or digital activities that offer web-based means of electronic payment (**World Pay**, **Pay Pal, Stripe** etc..).

[31] Court of Justice of the European Union, Asociación Profesional Élite Taxi v. Uber Systems Spain SL, 20 December 2017, C-434/15

This subtype of business model is particular for the provided service that can be purely digital if related to processing web payments and poses problems under the location criteria of OECD if there is no Permanent Establishment in the Member State.

For such providers the Directive, which organises electronic payments[32], gives cause to a direct legal base for the obligation to hold an office in the Member State where these providers operate (see the following section).

III. Non-tax law requirements.

50. Tax distortion that is triggered or facilitated through digital activities had better be addressed through new definitions (free services, users, data and the worldwide profit derived through them, Virtual Permanent Establishments) in the Union tax law and OECD.

But, as pointed out, negotiating and voting addendums to the existing tax treaties to insert these new tax law definitions, might take up a very long period of time. A unilateral taxation may, on the other hand, be questioned in court as long as these addendums do not take effect. Tax revenue may have to be reimbursed if such a claim prevails.

Hence the scope of this article: to seek a way around this temporary obstacle through non-tax law requirements of presence that may in turn give cause to apply existing Permanent Establishment criteria.

51. A historical interpretation of the general intention of Article 5 is the goal to enable taxing the profit created on the territory of a State through a permanent form of activity in the territory. Hence the criterions of presence that were historically defined.

Data collected from users and users themselves form substantial sources of profit that are created in a permanent way through all the digital interfaces located in the State that feeds that activity.

The provider offers services on these digital interfaces of the residents in the territory of the Member State. The presence of cookies left on the various digital interfaces of users in the Member State could be taken into account to qualify such material digital interfaces as tools to enhance the detection and extraction of the user's data.

It is not relevant for Article 5 that such a material digital interface does not belong to the company. It suffices that the presence of tools on all these material digital interfaces leads to a constant digital activity. Forming an activity of a permanent nature as historically intended.

[32] DIRECTIVE (EU) 2015/2366 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC, *OJ*, L 337/35, 23 December 2015 – Article 29 (4).

Such an argument may be useful when discussing the good faith of a contracting party in taxing profit that is generated in a permanent way, in its territory, through cookie-activity, in countless material digital interfaces of users.

52. A branch is not defined by OECD, nor is business.

A permanent presence of material digital interfaces in the territory of the contracting party that allows data detection and extraction could therefor be interpreted under Article 5, § 2, (b) OECD MC.

However, if presented alone, this criterion is open for various interpretations and could lead to contradictions in rulings from national tax judges both in Member States and between Member States. Aforesaid uncertainty ought to be avoided.

53. An 'office' under article 5, § 2 (c) OECD MC is a more tangible criterion.

It would lead to a more predictable outcome of tax litigation if combined or not with article 5, § 2, (b) OECD MC and the historical interpretation.

The presence of such an office can be obtained through requirements of non-tax law.

54. From the aforementioned analysis of the different business models of relevant digital activities, the following requirements can be considered to give a valid cause to impose a physical presence in the territory of the Member State that may in turn lead to Permanent Establishments for tax purposes.

- data protection, criminal investigation, fake news containment, official warnings of an imminent and imperative nature (users)
- regulations that secure electronic payments in general (electronic (digital) payment service)
- regulations on providers of services when not offered by the collector of the price

55. Member States could consider the issue of **fake news** on social media by demanding that companies that take the commercial risk of offering a digital forum in the territory, are liable when the spreading of false information is not contained and / or erased within a certain time limit.

In order to detect and contain the source of fake news, which would typically be a short-term event, it could be required to temporarily store the exchanged content on a server located in the national territory. This stored data is deleted after a given period of time (for instance 14 days). At the very least the presence could be required of an office with a terminal that gives access in the national language to the servers outside the territory.

That would allow the national authorities to detect and contain fake news that has given an unlawful cause of harm to citizens or authorities. Given the short time notion to stop the spreading and to root out fake news, a direct liaison office should be available to immediately reply and give access to the national authorities or habitants in their official language and in

their national territory in order to assist or direct the required interventions of protection and prevention.

56. In the author's view one should consider a digital forum in the Latin meaning of that word : it is a public square. Concepts of intimacy and privacy are misleading ; all that is written and shared remains in the public memory of those who were present on that square. It is therefor paramount to contain, as soon as possible, the spreading of harmful data from the originator/subject to the receiver/subject (minors' parents requesting immediate removal).

A direct liaison in the country of residence who offers direct contact in the national languages and means to immediately interfere in the spreading, is a necessary tool for that purpose.

57. Such a direct liaison could also serve, in a general way, **criminal investigations** and **security or consumer protection by issuing official warnings** on the digital forum used by the digital interfaces located in the territory of the Member State.

For instance, in case of a nuclear incident or spreading fires and floods, authorities could consider sending messages to the public in the affected area through digital forums as the most efficient way to warn the users who are located in or near that area.

Various services which are digitally split, could be considered as one service from a consumer's protection perspective and the whole of the information on the executed operation could be made available to the consumer in his national language and in his country.

The consumer's interests are also better served and more effective if he can legally call the organiser of the service before his national courts. Having an office that can be validly notified would greatly reduce the legal costs for consumers who consider that their rights have been violated by a service contracted through their digital interface in their usual place of residence. Even if some part of that service took place outside the territory.

58. This concern of protection of the interests of users can also be effectively addressed under two, more specific, non-tax law notions that have to be implemented no later than early 2018 in the national law of the Member States.

For free services, there is the implementation of data protection. For paying services, there is both the implementation of data protection and electronic payment protection.

This implementation offers a unique opportunity to swiftly address some tax distortion through digital activities.

59. For **data protection** requirements, the Directive (EU) 2016/680 of 27 April 2016 on personal data protection[33] may prove relevant for Member States for digital tax definition purposes. Member States have to implement these rules by **6 May 2018**.

[33] Directive (EU) 2016/680 of 27 April 2016 on the protection of natural persons with regard to the processing of personal data by competent authorities for the purposes of the prevention, investigation,

The following considerations of the Directive would allow the Member States to require a direct liaison on their territory :

> *"(3) Rapid technological developments and globalisation have brought new challenges for the protection of personal data. The scale of the collection and sharing of personal data has increased significantly.* ***Technology allows personal data to be processed on an unprecedented scale in order to pursue activities such as the prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties****."*
>
> *"(65) Where personal data are transferred from a Member State to third countries or international organisations,* ***such a transfer should, in principle, take place only after the Member State from which the data were obtained has given its authorisation to the transfer****."*
>
> *"(89) Penalties should be imposed on any natural or legal person, whether governed by private or public law, who infringes this Directive. Member States should ensure that the penalties are* ***effective, proportionate and dissuasive and should take all measures to implement the penalties****."*

60. The following tools must be implemented (Article 3) :

- All automated processing of personal data is prohibited unless authorised under Member State law (Article 11).
- All processing activities of this personal data must be recorded by the controllers (Article 24).
- Logs must be kept for controlling purposes of data collection, alteration, consultation and disclosure including transfers, combination and erasure (Article 25).

  This is also the case outside the European Union :

  > *"Article 24 (2) c where applicable, transfers of personal data to a third country or an international organisation where explicitly instructed to do so by the controller, including the identification of that third country or international organisation;"*

- Articles 35 (1) b and 39 prohibit transfer of personal data to third countries that do not have an authority for data protection as set out under Article 1 (1) of the Directive.

61. These elements are also potential useful tax tools next to giving cause for the presence of an Permanent Establishment :

- they allow to identify the companies that collect such personal data with an undisputed economical value,

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detection or prosecution of criminal offences or the execution of criminal penalties, and on the free movement of such data, and repealing Council Framework Decision 2008/977/JHA, *OJ*, L 119, 4 May 2016, p. 89

- they allow to quantity the number of users on their national territory and the amount of data given by these users,
- they allow to control the tax reporting of the companies that qualify under digital tax measures on business models that exploit users and their data.

62. Under CHAPTER V "Transfers of personal data to third countries or international organisations" of the Regulation (EU) 2016/679 of 27 April 2016 [34] the Commission controls if third countries provide similar adequate protection as the Regulation organises between Member States.

The personal data defined under this Regulation is relevant since it directly relates to the difficulties expressed by the participants under the OECD's public enquiry on how to grasp the economic value of worldwide data mining activities of data collected from a State's territory.

- considerations (23 and 24) :

> *"..the processing of personal data of data subjects who are in the Union by a controller or a processor not established in the Union should be subject to this Regulation where the processing activities are related to offering goods or services to such data subjects irrespective of whether connected to a payment..(..) factors such as the use of a language or a currency generally used in one or more Member States with the possibility of ordering goods and services in that other language, or the mentioning of customers or users who are in the Union, may make it apparent that the controller envisages offering goods or services to data subjects in the Union..*
>
> *(24) The processing of personal data of data subjects who are in the Union by a controller or processor not established in the Union should also be subject to this Regulation when it is related to the monitoring of the behaviour of such data subjects in so far as their behaviour takes place within the Union. In order to determine whether a processing activity can be considered to monitor the behaviour of data subjects, it should be ascertained whether natural persons are tracked on the internet including potential subsequent use of personal data processing techniques which consist of profiling a natural person, particularly in order to take decisions concerning her or him or for analysing or predicting her or his personal preferences, behaviours and attitudes."*

All data collected from "data subjects who are in the Union", with or without payment from these "data subjects" must be traceable in and outside the Union. This is indispensable for both the supervision on how and by whom the collected data are 'processed' and the enforcing of the data subject's rights granted under the Regulation.

[34] REGULATION (EU) 2016/679 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation), *OJ*, L 119/1, 4 May 2016

The tracing back of the collected data to the user can be done most effectively if this collecting was recorded on a server in that user's Member State. In would ensure the most immediate and timely access and supervision.

- considerations (73, 80 and 82) :

> *"(74) The responsibility and liability of the controller for any processing of personal data carried out by the controller or on the controller's behalf should be established. In particular, the controller should be obliged to implement appropriate and effective measures and be able to demonstrate the compliance of processing activities with this Regulation, including the effectiveness of the measures. Those measures should take into account the nature, scope, context and purposes of the processing and the risk to the rights and freedoms of natural persons.*
>
> *(80) Where a controller or a processor not established in the Union is processing personal data of data subjects who are in the Union whose processing activities are related to the offering of goods or services, irrespective of whether a payment of the data subject is required, to such data subjects in the Union, or to the monitoring of their behaviour as far as their behaviour takes place within the Union, the controller or the processor should designate a representative (..)*
>
> *(82) In order to demonstrate compliance with this Regulation, the controller or processor should maintain records of processing activities under its responsibility. Each controller and processor should be obliged to cooperate with the supervisory authority and make those records, on request, available to it, so that it might serve for monitoring those processing operations."*

The Commission thus potentially controls very effective tools in identifying and qualifying digital activity in each Member State. Major parts of the digital economy become transparent and traceable for taxing purposes of digital activities.

Through the requirement of an office (direct liaison with legal notification purpose) a Permanent Establishment under existing tax treaties is made while awaiting the addendums to implement the definitions of Virtual Permanent Establishments.

This is a highly relevant competence of the Commission that may qualify under Article 292 TFEU and may in turn in a significant way improve the Member State's tools to insert in their national tax law equal tax burdens on all national, European or third country competitors alike. This Regulation becomes effective on **25 May 2018**.

63. Under consideration (23) of this Regulation, the processing of personal data should take place even when no payment is involved. A large portion of digital activities does not relate to persons but to business.

Business related data does not fall under the scope of these data protection rules.

It can be assumed however that the bulk of data generated by business, results in electronic payments. Requirements for implementing electronic payment protection may offer a motivation to impose an office for business related data purposes while awaiting the implementation of the addendums to the tax treaties that relate to Virtual Permanent Establishments.

Also, whereas some services are available for free from business to business, the author reminds that the freedom of services in the Integrated Market is qualified by Article 57 TFEU as those services that are *normally provided for remuneration*.

Member States could argue that they can also install, under the scope of free business to business services, offices / direct liaison requirements for some of the same purposes as set out for personal data protection ; criminal investigations (cyber-attacks), fake news containment (that could be considered even potentially more damaging in a business environment), industrial espionage (fake profiles, references etc..), and as a general warning tool when unexpected events occur.

64. For **electronic payment protection** requirements, the Directive (EU) 2015/2366 of 25 November 2015 on payment services[35] may prove highly relevant for Member States in digital tax definition purposes.

Member States have to implement these rules by **13 January 2018**. This date does not exclude that these rules may be further implemented and fine-tuned after that date.

65. This Directive imposes the following obligation on Member States :

(Article 101 (1 and 2) : Dispute resolution)

"Those procedures shall be applied in every Member State where the payment service provider offers the payment services and shall be available in an official language of the relevant Member State or in another language if agreed between the payment service provider and the payment service user."

"Member States shall require that payment service providers make every possible effort to reply, on paper or, if agreed between payment service provider and payment service user, on another durable medium, to the payment service users' complaints. Such a reply shall address all points raised, within an adequate timeframe and at the latest within 15 business days of receipt of the complaint."

Member States can argue that the effectiveness of these Dispute resolution requirements are best met with the presence of an office in their territory.

[35] DIRECTIVE (EU) 2015/2366 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC, *OJ*, L 337/35, 23 December 2015

66. The Directive states' personal data obtained through payments systems must also comply with data protection requirements (Article 94). The Commission confirmed on 27 November 2017 that the personal Data protection requirements apply equally when they become effective on 25 May 2018[36].

This opens up a combined requirement of national offices for electronic payments that relate to consumers. Article 29 (4) states in that regard :

> *"4. **Member States may require** payment institutions operating on their territory through agents under the right of establishment, the head office of which is situated in another Member State, **to appoint a central contact point in their territory** to ensure adequate communication and information reporting on compliance with Titles III and IV* (*)*, without prejudice to any provisions on anti-money laundering and countering terrorist financing provisions and to facilitate supervision by competent authorities of home Member State and host Member States, including by providing competent authorities with documents and information on request."*

(*) Articles 94 and 101 fall within Title IV of the Directive

The Directive further states that the electronic payment data must be stored five years, *without prejudice to Directive (EU) 2015/849 or other relevant Union law* (Article 21).

67. Consequently, Member States can require the presence of an office on their territory, even if the payment institution is incorporated in another Member State.

This gives cause to a potential decisive element in the discussion whether or not a Permanent Establishment could be made present under existing OCDE criteria through electronic payment requirements.

68. However, a word of caution is needed. The caution relates to the effectiveness of the use of the collected financial data for national tax purposes.

Under Article 26 of the Directive, the exchange of information between Member States is regulated. Article 26 (2) states :

> *"2. Member States shall, in addition, allow exchange of information between their competent authorities and the following:*
> *(..)*
> *(c) other relevant authorities designated under this Directive, Directive (EU) 2015/849 and other Union law applicable to payment service providers, such as laws applicable to money laundering and terrorist financing;"*

Could this phrasing include the exchange of information requested by national tax administrations with the purpose of determining the profit tax base of the *recipients* of electronic payments originated in that Member State ?

[36] http://europa.eu/rapid/press-release_MEMO-17-4961_en.htm, section 4 'Protection of personal data'.

This seems questionable since the wording only specifically exonerates '*other Union law (..) such as laws applicable to money laundering and terrorist financing'*. Using the stored electronic payments data for national tax law purposes seems impossible under Article 26 (2) of the Directive.

69. When this Directive was adopted in November 2015, the 'Swiss' and 'Lux' leaks were already public, but that general and political awareness was further triggered by the following 'Panama', 'Bahama' leaks or 'Paradise' papers.

Several companies active in digital activities were so named in extensive tax engineering purposes and have since provoked a political momentum in the European Union which effectively wishes to address these legal loopholes.

The on-going legislative efforts of the European council and commission in addressing tax-avoidance through digital activities may so lift this restriction under Article 24 (2) c for national tax purposes or lead to other Union law which allows the monitoring of electronic payments data for tax purposes.

While awaiting such initiatives, a Member State could argue that the Council Directive (EU) 2016/116 of 12 July 2016, implementing rules against tax avoidance practices which directly affect the functioning of the internal market, and other new Union laws who will be adopted in 2018, forms Union law that can qualify under the general requirement of Article 24 (2) c.

70. Such a demand of a Member State to another Member State to share the collected payment data for tax purposes would then best be motivated by national tax law, that was adopted in transposing Union tax law in national tax law, and clearly mention the transposed Union tax law in that nation tax law and how the demand to share the collected payment data serves the purposes as set out by that Union tax law. It remains to be seen if tax subjects can successfully challenge the production of these collected payments data before national tax courts for taxation purposes.

This uncertain outcome of tax litigation could be lifted once Article 24 (2) c is modified.

71. It is also important to remind the reader that the fields of criminal law, personal data protection and electronic payment protection (if qualified as financial services) fall outside the scope of Directive 2006/123 of 12 December 2006 on services in the internal market[37] .

This Directive grants the following rights under the Internal Market of services :

- Member States cannot request a prior authorisation of a service activity on their territory unless some conditions are met (Article 9 (1)),

[37] DIRECTIVE 2006/123/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 12 December 2006 on services in the internal market, OJ, L 376, 27 December 2006, p. 36, Articles 1 (5), 2 (2) b and c, 17 (3) and considerations n° 18 and 20.

- Member States cannot enforce certain requirements (Article 14), such as (Article 14 (3)) :

  "restrictions on the freedom of a provider to choose between a principal or a secondary establishment, in particular an obligation on the provider to have its principal establishment in their territory, or restrictions on the freedom to choose between establishment in the form of an agency, branch or subsidiary;"

- Member States can in general only enforce requirements on providers that are established in another Member State if some conditions are met (Article 16 (1)), however without (Article 16 (2)) :

  "Member States may not restrict the freedom to provide services in the case of a provider established in another Member State by imposing any of the following requirements:

  (a) an obligation on the provider to have an establishment in their territory;"

As said, the fields of criminal law, financial services and personal data protection are excluded. Member States can enforce the forbidden or restricted requirements and authorisations in these fields. They would however do well to observe in that matter the criteria of non-discrimination, proportionality and necessity that can be expected from legislation in general.

Also, Article 4 (1) qualifies a service under this Directive as an economic activity, normally provided for remuneration. Again, the digital activities that relate to free services and free users could be considered not to fall under the granted rights.

And, if in doubt over the presence in that legislation of an indirect goal that relates to tax purposes, Article 2 (3) excludes the field of taxation of its scope.

72. The more specific Directive 2000/31 of 8 June 2000 on electronic commerce[38] also excludes the field of taxation of its scope (Article 1 (5)). This Directive grants the right to providers established in a Member State to provide 'information society services' without restrictions in all other Member States.

The protected services must be of a commercial nature. Consideration 18 includes :

"extend to services which are not remunerated by those who receive them, such as those offering on-line information or commercial communications, or those providing tools allowing for search, access and retrieval of data;"

But excludes personal mail services and services that generally require the physical presence of the provider :

[38] DIRECTIVE 2000/31/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (Directive on electronic commerce), OJ, L 178, 17 July 2000, p. 1

"the use of electronic mail or equivalent individual communications for instance by natural persons acting outside their trade, business or profession including their use for the conclusion of contracts between such persons is not an information society service (..) activities which by their very nature cannot be carried out at a distance and by electronic means, such as the statutory auditing of company accounts or medical advice requiring the physical examination of a patient are not information society services."

73. The granted rights can however be infringed by the Member States if they observe some conditions. If Uber was found to be an intermediary providing information society services and not a provider of transport services, the requirements laid on the Spanish company of Uber had to meet these conditions under Article 3 (4) (a) :

(i) necessary for one of the following reasons:

- public policy, in particular the prevention, investigation, detection and prosecution of criminal offences, including the protection of minors and the fight against any incitement to hatred on grounds of race, sex, religion or nationality, and violations of human dignity concerning individual persons,
- the protection of public health,
- public security, including the safeguarding of national security and defence,
- the protection of consumers, including investors;

(ii) taken against a given information society service which prejudices the objectives referred to in point (i) or which presents a serious and grave risk of prejudice to those objectives;
(iii) proportionate to those objectives;

74. When reading the considerations to this Directive, the general goals of various protections (fake news, criminal law, consumers, personal data protection, electronic payment protection,.) which were suggested in this article, fall within the possible legitimate fields to impose restrictions on providers of information society services which are established in other Member States (considerations 11, 45, 52 and 57) :

"(11) This Directive is without prejudice to the level of protection for, in particular, public health and consumer interests, as established by Community acts (..) those Directives also apply in their entirety to information society services; which is fully consistent to information society services (..)

(45) The limitations of the liability of intermediary service providers established in this Directive do not affect the possibility of injunctions of different kinds; such injunctions can in particular consist of orders by courts or administrative authorities requiring the termination or prevention of any infringement, including the removal of illegal information or the disabling of access to it (..)

(52) The effective exercise of the freedoms of the internal market makes it necessary to guarantee victims effective access to means of settling disputes (..)

(57) The Court of Justice has consistently held that a Member State retains the right to take measures against a service provider that is established in another Member State but directs all or most of his activity to the first Member State if the choice of establishment was made with a view to evading the legislation that would have applied to the provider had he been established on the territory of the first Member State."

Restrictions, through the implementation of the Directives in the fields of personal data protection and electronic payment protection, would then not constitute to violations under this directive (consideration 11).

Nor would the presence on the territory of the Member State of a direct liaison of the provider for criminal and fake news purposes be a violation as such (consideration 45).

Nor the requirement of an office of the provider for victims / consumers to send notification to the provider in their national language and if needed call that provider before their national judges (consideration 52).

75. The Commission has, under Article 3 (6) of the directive, the power to examine the legislation which restricts the granted right, and notify the Member State if the Commission finds that the conditions under Article 3 (4) were not met.

Again, the Commission could then consider, under Article 3 (6) of this Directive and Article 292 TFEU, to establish guidelines for Member States who wish to adopt legislation that imposes a form of physical presence to providers of information society services that have a sufficient large and constant way of digital activity on the territory of that Member State.

76. Another Directive that may intervene in adopting national legislation that relates to relevant digital activities, is the obligation to communicate and postpone such legislation under the Articles 8 and 9 of the Directive 1998/34 of 22 June 1998.

This applies to legislation that adopts a 'requirement of a general nature relating to the taking-up and pursuit of service activities (..), in particular provisions concerning the service provider, the services and the recipient of services'.

77. Again, only services that are normally provided for remuneration at a distance by electronic means and at the individual request of a recipient would qualify under its scope (Article 1 (2)). Article 1 (5) explicitly excludes rules that do not relate to such services. So legislation regarding free users and free service cannot qualify for this Directive.

Article 10 (1) states that the Articles 8 and 9 do not apply to legislation that complies with binding Community acts on such services. The legislation adopted to implement the personal data protection and electronic payment protection Directives could fall under this exclusion.

Other legislation, which qualifies as a requirement of a general nature, may have to observe the obligations of communication and postpone the adoption of the rules for six months. During that period, other Member States may suggest comments on the announced legislation. However Article 8 (1) states :

"..the comments or detailed opinions of the Commission or Member States may concern only aspects which may hinder trade or, in respect of rules on services, the free movement of services or the freedom of establishment of service operators and not the tax or financial aspects of the measure.."

The effect of such legislation on taxation cannot be invoked to oppose this legislation. But requirements for a direct liaison in the Member State fall under the free movement of services or the freedom of establishment of service operators.

These two freedoms are organised through the two other commented Directives[39]. If the requirement for a direct liaison falls within the scope of these two Directives and complies with them, there is no cause for further debate under this Directive. If the requirement does not fall in the scope of these two Directives, then there seems to be no ground of violation of the said freedoms by the projected legislation.

78. In conclusion, these three Directives do not oppose adopting requirements by Member States that relate to digital activities for non-tax law purposes such as personal data protection, electronic payment protection, fake news, criminal investigations, consumer protection…

The fact that these requirements may in turn lead to taxation of these digital activities is irrelevant under the scope of these three Directives.

IV. Conclusions.

79. The electronic payments Directive covers both personal and business data and offers an explicit legal stand-alone base to impose, on all providers of such services in a Member State, the obligation to organise an office on the territory of that state.

All providers of such services could therefor fall under the scope of the existing definition of Permanent Establishments of Articles 5, § 2 (b) and (c) OECD MC.

The personal data protection Directive offers a non-explicit legal base to require from all entities, which collect personal data from users in a Member State, to organise an office in that Member State. National law could further justify this obligation under various other safety and prevention requirements combined with the implementation of the personal data protection Directive.

[39] DIRECTIVE 2006/123/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 12 December 2006 on services in the internal market, OJ, L 376, 27 December 2006, p. 36, Articles 1 (5), 2 (2) b and c, 17 (3) and considerations n° 18 and 20 and DIRECTIVE 2000/31/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (Directive on electronic commerce), OJ, L 178, 17 July 2000, p. 1

As far as non-personal data obtained through free services was collected in a Member State, that Member State could declare similar provisions applicable since this type of service does not fall under the scope of Article 57 TFUE. The Member State could motivate such a national legislation with references to the same concerns of safety and prevention.

By defining under national law that all national legal requirements for national based providers of services also apply to the company that collects the income from such services, these national requirements would then generally also lead to a criterion of localisation under OECD rules for Permanent Establishment purposes.

80. Combined together, these non-tax law measures may lead to Permanent Establishments for large portions of the digital economy in the territory of a Member State which at present does not have a Permanent Establishment under existing OCDE criteria.

Falling under the Union law and the national tax law of that Member State, according to to existing tax treaty criteria, is the first condition to effectively address tax distortion of the Internal market by various anti-avoidance measures.

While waiting for more effective measures such as Virtual Permanent Establishments to be adopted and take effect, this strategy may prove effective in reducing existing tax distortion through digital activities.

81. As mentioned in the beginning of this article, new VAT rules on electronic commerce[40] are part of the EU's 'digital single market' strategy of the Council. This strategy, adopted by the Council on 13th September[41], has given cause to draft a regulation for the free flow of non-personal data in the European Union, adopted by the Council on 17th December 2017. This draft was made public by the Council on 20th December 2017[42].

This draft of regulation on non-personal data is currently under discussion in the European Parliament and prohibits Member States to impose any kind of physical presence on the provider of electronic services that don't relate to personal data under the Data Protection Union law.

Consequently, this draft of Regulation allows a free choice of where serves are located within the territory of the European Union. The only exception under the present Article 4, relates to public security.

82. A debatable question is if the freedom of localisation of servers in the European Union, granted under this draft text, needs to include terminals who can grant full access to these servers.

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[40] http://www.consilium.europa.eu/en/press/press-releases/2017/12/05/vat-on-electronic-commerce-new-rules-adopted/

[41] http://data.consilium.europa.eu/doc/document/ST-12202-2017-INIT/en/pdf

[42] http://www.consilium.europa.eu/nl/press/press-releases/2017/12/20/removing-barriers-to-free-flow-of-data-council-agrees-its-position/

That would prohibit Member States who seek effective taxation of digital profits originated in their territory, to impose a physical presence of a server or a terminal for other reasons than public security.

Such other reasons may be : consumer protection ; fake news ; criminal investigations, tax investigations ..

Attempts of Member States to bypass unwillingness on both European and international levels in creating timely tools of effective taxation in the digitally shifting economy could thus, to a certain extent, be rendered ineffective with regard to non-personal data.

There is also the linked question of 'mixed' data which is partially non-personal and partially personal. Who will control and qualify the content of alleged non-personal data? Which directive is then to receive priority?

83. The author therefor finds it more prudent, for the purpose of taxing digital activities and discussions over permanent establishments which will inevitably occur, that under Article 4 of the draft Regulation on the Digital Single Market the same criteria should be considered as under the Union law as was discussed above :

a) Directive 2006/123 of 12th December 2006 on services in the Internal Market ; article 2 (3) excludes the field of taxation of its scope.

b) Directive 2000/31 of 8th June 2000 on electronic commerce under Article 1 (5).

c) Article 3(4) a of the Directive 2000/31 of 8th June 2000 on electronic commerce : protection of consumers, including investors, public policy (criminal, racism, personal insults (fake news)), public health and public security ?

   Only the last reason is included under Article 4 of the draft of Regulation on the Digital Single Market.

These larger exceptions would still have to be proportionate: mainframes and other heavy installations could still be placed at the location of the provider's discretion. But Member States could then require from that provider, in accordance with the larger exceptions, a physical access point on their territory to that stored data. Such a point could consist of an office that can offer assistance in the national language and the national procedures in accessing the servers through a terminal located in that office.

84. Consequently, in accordance to the ongoing efforts of the Commission that relate to addressing disinformation and fake news, national access points or storage for all kinds of data, may prove necessary. Isn't the user the first in line who must be capacitated to check the stored data which relates to him? How to capacitate him better then by organising his right to check this information in an office in his country, assisted by the provider, in his own national language?

Why does non-personal data remain unchecked by Member States for other reasons than public security? What makes it different from personal data for those other reasons? Because it is considered business related content?

Why should information, spread by a professional website or mails in the territory of a Member State, be less harmful than content in personal mails?

Hopefully a serious debate will be held in the European Parliament regarding the question if those other reasons aren't legitimate enough to allow Member States to use their right to require a direct liaison in their territory for data control purpose. This liaison does not necessarily require a server, but the minimal requirement of the presence of a terminal which grants full access, seems logic. Such monitoring can only be effective by enforcing that a server is located or is made accessible to the national authorities through a terminal in an office of the provider on the territory of the Member State.

Following the German legislation which requests Facebook to monitor information exchange and eradicate fake news / terror etc., this will in due time result in over a 1000 people who will be employed by Facebook in Germany in order to comply to this policy alone.

85. The issue of taxing digital activities and the power to do so under existing tax treaties will certainly give cause for major discussions both in and outside the European Union in 2018.

Inside the European Union Member States who at the moment tax digital activities or are considering to tax digital activities, would do well to closely follow up new European law on the Digital Single Market if they still wish to be able to effectively tax digital activities on their territory in the near future.

Brussels, 5th February 2018.