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Artykuły

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# The concept of "economic presence" for the taxation of cross-border corporate income in the OECD area of activities

**Summary.** For several years, the OECD has been conducting analyses to adapt the taxation model of cross-border corporate income. This is in response to changing strategies for entering foreign markets, especially for digital economy companies that may not require a physical presence in the expanded market country. The paper examines the new nexus based on the concept of "economic presence" in the light of the erosion of the permanent establishment in the digital economy. Its main purpose is to assess the consequences of the introduction into international taxation of a mechanism that allows a source country to tax the income of a foreign company in the absence of traditional, "physical" manifestations of the presence of such a company in that country.

**Keywords:** permanent establishment, digitalisation, economic presence, Pillar One, Amount A

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## Koncepcja „obecności ekonomicznej” dla opodatkowania transgranicznych dochodów przedsiębiorstw w działaniach OECD

**Streszczenie.** OECD od kilkunastu lat prowadzi prace analityczne mające na celu dostosowanie modelu opodatkowania transgranicznych dochodów przedsiębiorstw w warunkach zmieniających się strategii wejścia na rynki zagraniczne, które – zwłaszcza w przypadku tzw. przedsiębiorstw gospodarki cyfrowej – nie wymagają w wielu przypadkach „fizycznej” obecności na terytorium państwa ekspansji rynkowej. W artykule poddano analizie założenia nowego łącznika (*nexus*) opartego na koncepcji „obecności ekonomicznej” w świetle erozji koncepcji stałego zakładu w warunkach gospodarki cyfrowej. Zasadniczym celem artykułu jest ocena możliwych konsekwencji wprowadzenia do modelu opodatkowania międzynarodowego mechanizmu umożliwiającego państwu źródła opodatkowanie dochodów zagranicznej spółki, w przypadku braku tradycyjnych, „fizycznych” przejawów obecności takiej spółki w danym państwie.

**Słowa kluczowe:** stały zakład, cyfryzacja, obecność ekonomiczna, filar I, kwota A

### 1. Introduction

The transformations and opportunities related to the use of cyberspace, observed from the perspective of market mechanisms and the behaviour of the participants of economic processes, is most often referred to as the “digital economy”, where the role of enterprises as entities creating organisational structures, business models, and methods of generating revenue through or even “in” cyberspace is key.[1]

The digital transformation of the economy calls into question whether the international tax rules that have largely been in place for most of the past 100 years are still fit for purpose in the modern global economy. These rules relate to the allocation of taxing rights between jurisdictions (the “nexus” rules) and to the determination of the relevant proportion of the multinational’s profits that are subject to tax in a given jurisdiction (the “apportionment” rules). There is a question as to whether the existing nexus rules, which determine the extent of a jurisdiction’s right to tax a non-resident company, may be outdated “as a company may now be heavily involved in the economic life of a jurisdiction but have a presence that, under existing tax rules, gives rise to minimal or no taxing rights for that jurisdiction.”[2]

[1] R. Lipniewicz, *Jurysdykcja podatkowa w cyberprzestrzeni. Model międzynarodowego opodatkowania dochodu*, Warszawa 2018, p. 266.

[2] OECD, *Tax and digitalisation*, 2019, https://www.oecd.org/tax/beps/tax-and-digitalisation-policy-note.pdf (accessed: 11.02.2024).

This applies in particular to the institution of a permanent establishment (PE), which is of key importance from the point of view of the taxation of income from cross-border business activities of companies. Its structure is based on the paradigm of a permanent establishment through which such activity is conducted. Pursuant to Article 7 of the OECD Model Tax Convention, on which tax treaties between countries are based, in order for the country in which the income is generated (also referred to as the "source country" or the "market country") to impose a limited tax on such income in accordance with the territorial jurisdiction of the courts of the source country, such an entrepreneur must exceed a certain threshold of "physical" presence and activity in the source country.

The historical evolution of the ways in which entrepreneurs have expanded internationally, despite changing strategies and business models, shows that such presence has usually been (and in the case of traditional industries – still is) manifested through the involvement and use of certain physical assets in the country of entrepreneurial activity, i.e. real estate, machinery, equipment, or personnel. An increase in the number of enterprises based on highly digitised business models – as one of the effects of the development of computer networks and digital technologies – leads to the exploration of foreign markets and the generation of income that requires little or no involvement of such assets. This calls into question the possibility of using the permanent establishment concept as an instrument to exercise effective tax jurisdiction by the market country.

Attempts have been made in international tax law to develop the concept of a new nexus.[3] Its purpose was to enable the source country to exercise its tax jurisdiction over foreign companies whose "presence" – aimed at creating value in (or within) such a country – has a dimension other than material (physical), leading to the creation of a permanent establishment. However, the analytical work carried out (and still being carried out) by the OECD in the framework of the Base Erosion Profit Shifting (BEPS) project has given this matter new impetus.[4] The indirect results of this are unilateral legislative measures taken by individual countries, some of which have already introduced into their national legal systems a new paradigm

[3] See: P. Hongler, P. Pistone, *Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy*, "IBFD Working Paper", 20 January 2015, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2591829 (accessed: 11.02.2024).

[4] See: OECD, *Base erosion and profit shifting (BEPS)*, n.d., https://www.oecd.org/tax/beps/ (accessed: 11.02.2024).

of a foreign company's "economic (digital) presence" on the local market (Israel, India). The unilateral actions were the result of the lack of consensus within the OECD Inclusive Framework (IF) on BEPS regarding the possibility of establishing a new right to tax cross-border corporate income (nexus) based on a criterion other than "physical presence" in the territory of the country where the source of income is located.

The general paradigm accepted by the OECD as a basis for analytical work was rooted in the concept of the economic presence of a company on the territory of a country other than its own country of tax residence. The practical approach to the concept of economic presence in the proposals for the new nexus has evolved in recent years to finally take the form included in the text of the Multilateral Convention to Implement Amount A of Pillar One, published in 2023.

## 2. A fixed place of business and the digital economy

### 2.1. A fixed place of business in the OECD Model Tax Convention

The reasons for the international emergence of a permanent establishment should be sought in the double taxation of income earned by companies operating in more than one country. The legal concept of such an establishment developed at the beginning of the 20th century during the Second Industrial Revolution and the expansion of production facilities. In these economic conditions, the concept of establishment was formed mainly by classical factors of production, such as labour and capital, when their mobility between countries was still limited. The focus was on manufacturing enterprises, largely "tied" to a particular territory, and there was little interest in service enterprises. The concept of the plant was thus developed in an economic environment characterised by limited mobility of the factors of production, which rarely led to disputes over the scope of the taxation of a foreign plant.[5]

A PE is a trade-off between the taxing jurisdiction of the source state and the residence state. It determines whether an enterprise operating in more than one country is subject to tax on its business profits only in the

[5] R. Lipniewicz, *Podatkowy zakład zagraniczny. Koncepcja i funkcjonowanie*, Warszawa 2017, p. 25.

country of residence, or is also subject to tax on the same business profits in one or more of the countries in which it operates.[6]

The existence of a PE in the source state (market jurisdiction) is the critical condition that must be met for the source state to be entitled to tax an enterprise of the other state on its business profits. The definition of a PE is based on the concept of a fixed establishment and may also include (depending on which model – the OECD[7] or the UN[8] – is followed) service or construction activities carried on for a specified period of time, the existence of a dependent agent, and the collection of insurance premiums. A PE effectively acts as a threshold that "measures the degree of real economic presence of the non-resident in a jurisdiction."[9]

The creation of a permanent establishment has a significant impact on the legal and tax situation of the entrepreneur in the country of its foreign market activity; in addition to the tax obligation to pay tax on income related to the establishment, the entrepreneur is obliged to fulfil a number of administrative obligations (reporting the establishment to local tax authorities or keeping separate accounts).[10]

The basic type of foreign establishment is based on the "fixed place of business" axiom and the wording of Article 5(1) of the OECD Model Tax Convention, according to which a "permanent establishment" means a "fixed place of business through which the business of an enterprise is wholly or partly carried on". The definition of a basic type of permanent establishment is, therefore, based on the assumption that the business activities of a foreign company will only be taxable in a given country if

[6] M.K. Singh, *Taxing E-Commerce on the Basis of Permanent Establishment: Critical Evaluation*, "Intertax" 2014, no. 5, p. 327.

[7] OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, Paris 2017, https://www.oecd.org/ctp/treaties/model-tax-convention-on-income-and-on-capital-condensed-version-20745419.htm (accessed: 11.02.2024) (hereafter referred to as the "OECD Model Tax Convention").

[8] United Nations, *Model Double Taxation Convention between Developed and Developing Countries 2021*, 2021, https://financing.desa.un.org/document/un-model-double-taxation-convention-between-developed-and-developing-countries-2021 (accessed: 11.02.2024).

[9] UN Committee of Experts on International Cooperation in Tax Matters, *Tax Issues related to the Digitalization of the Economy: Report*, 5 April 2019, https://www.un.org/esa/ffd/wp-content/uploads/2019/04/18STM_CRP12-Work-on-taxation-issues-digitalization.pdf (accessed: 11.02.2024).

[10] T. Woźniak, *Powstanie zakładu a unikanie opodatkowania w międzynarodowym prawie podatkowym*, LEX/2022.

there are sufficiently strong economic ties between the source country and a company carrying on its business activities in that country.[11]

As per the OECD Commentary, setting up a permanent establishment based on the "fixed place of business" paradigm requires meeting three fundamental conditions. These conditions include the existence of a "place of business", this place of business being "fixed", and the enterprise conducting its business through this fixed place of business.[12]

The term "place of business" includes any premises, facilities, or installations used for carrying on the enterprise's business, whether or not they are used exclusively for that purpose.[13] A. Skaar defines "the place of business" as "any significant physical item that is economically suitable for use in the conduct of the business."[14]

The permanence of the establishment means that there should be a connection between the establishment and a particular geographical point. It is immaterial how long an enterprise of one contracting state carries on business in the territory of the other contracting state if it does not carry on business in a particular place. This does not mean that the facilities constituting an establishment must be permanently connected with the land on which they are situated; it is sufficient that they remain in a particular place.[15] The condition that the facility must be permanent implies that it should have some degree of permanence, i.e. it cannot be temporary. It is generally accepted that it should last at least six months, unless it is used for a brief period of time, but the use is repeated regularly over an extended period of time.[16]

The PE concept, on which the standard provisions of the OECD Model Tax Convention are still based, refers to the traditionally understood territorial jurisdiction of the state. In other words, it means that a sovereign state exercises its taxing authority over things, people, and events located within its territory.

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[11] A.M. Bardopoulos, *eCommerce and the Effects of Technology on Taxation*, Cham–Heidelberg–New York–Dordrecht–London 2015, p. 121.

[12] M. Jamroży, F. Majdowski, *Permanent Establishment in Digital Business*, "Studia Prawno-Ekonomiczne" 2022, vol. 122, pp. 13–14.

[13] *OECD Model Tax Convention*, Commentary on Article 5, point 10.

[14] A.A. Skaar, *Permanent Establishment: Erosion of Tax Treaty Principle*, Alphen aan den Rijn 1991, p. 123.

[15] H. Litwińczuk, *Międzynarodowe prawo podatkowe*, Warszawa 2021, p. 191.

[16] *OECD Model Tax Convention*, Commentary on Article 5, point 28; H. Litwińczuk, *Międzynarodowe…*, p. 192.

In the case of many types of "traditional" economic activities of companies, this paradigm still guarantees the implementation of the tax policies of the countries in which foreign companies carry out their business activities. Owing to the institution of a permanent establishment, the source countries receive preference (priority, but not exclusivity) in the taxation of income resulting from the performance of business activities on their territory by companies whose links with these countries are not significant enough to qualify as a tax resident (and subject to territorially-unlimited taxation).

However, the dynamic development of business models based on the effect of geographically-unlimited scope of operations using computer networks, combined with data analysis and the use of advanced algorithms, has been diagnosed in connection with the taxation of cross-border income, especially in the context of the analytical work of the OECD. It was identified as a process that undermines the status of a permanent establishment based on the fixed place of business test.

### 2.2. Guidelines on the OECD Commentary in response to an early development of e-commerce

The OECD undoubtedly initiated a broad debate on the impact of computer networks (especially the Internet) on the legal status of a permanent establishment. November 1997 marked a significant milestone in this process, when the OECD organised a joint government and business conference in Turku, Finland, entitled "Dismantling the Barriers to Global Electronic Commerce", the title of which underscored the OECD's overall approach. One key outcome of this conference was the establishment of ten general principles to promote the development of electronic commerce.[17]

At the opening of the 1998 OECD Ministerial Conference in Ottawa, called "A Borderless World: Realizing the Potential of Electronic Commerce", the Committee on Fiscal Affairs presented a report entitled "Taxation Framework Conditions". This report identified general tax principles that should apply to electronic commerce and implementation issues, including how these modern technologies allow tax administrations

[17] OECD, *Dismantling the Barriers to Global Electronic Commerce, Turku (Finland): 19–21 November 1997 – Conference Report*, "OECD Digital Economy Papers", no. 38, Paris 1998, http://dx.doi.org/10.1787/236647320075

to improve the service they provide to taxpayers. Establishing rules for the taxation of e-commerce was an important conceptual contribution. The rules were: neutrality, efficiency, certainty and simplicity, effectiveness and fairness, flexibility.[18]

Following the adoption of the Ottawa tax framework, work on its implementation progressed and in 2001 the Committee on Fiscal Affairs issued a report entitled "Taxation and Electronic Commerce: Implementing the Ottawa Tax Framework". The report summarised the considerable progress made on aspects of direct taxation, excise taxes, and tax administration, as well as identified further work to be done. From the formal point of view, the conclusions and recommendations of the Committee on Fiscal Affairs, published in 2001, were crucial.[19] Section 4.1 of this document contained amendments to the Commentary to the OECD Model Tax Convention, adopted by the Committee on Fiscal Affairs on 22 December 2000 and concerning the application of the current definition of a permanent establishment in the context of electronic commerce. These changes were introduced into the OECD Commentary as a result of the 2003 Update to the OECD Model Tax Convention. To date, they remain the official interpretation of the OECD Model Tax Convention regarding permanent establishment provisions.

The OECD Commentary on e-commerce focuses on assessing the tax consequences of two key elements that appear in different technological and business variants in business activities conducted using the Internet, namely (1) the technical infrastructure (hardware) through which the business is conducted and (2) the software used by these devices.

Given that the basic type of permanent establishment is based on the concept of a fixed place of business, which is used by a foreign enterprise to conduct business in the source country, the method of interpreting the "stability" of a particular economic structure becomes a key issue in assessing whether the criteria for a permanent establishment are met (with respect to e-commerce). The chosen method of interpretation will,

[18] OECD, *Report by the Committee on Fiscal Affairs as presented to Ministers at the OECD Ministerial Conference called 'A Borderless World: Realising the Potential of Electronic Commerce' on 8 October 1998*, Paris 1998, https://one.oecd.org/document/SG/EC(98)10/FINAL/en/pdf (accessed: 11.02.2024).

[19] OECD, *Taxation and Electronic Commerce. Implementing the Ottawa Taxation Framework Conditions*, Paris 2003, https://read.oecd-ilibrary.org/taxation/taxation-and-electronic-commerce_9789264189799-en#page1 (accessed: 11.02.2024).

therefore, depend on whether priority is given to the "physical", material manifestations of a company's presence and business activity in a country other than its country of tax residence, or, rather, to economic aspects, where the "economic participation" of a company in the economy of a given country will be decisive.

According to the OECD Commentary, the "physical and technical" approach takes precedence over the latter one. In other words, the elements of a company's physical presence and business activity using electronic means to conduct its business in a given country were considered decisive. A permanence test was proposed in the Commentary to the OECD Model Tax Convention. It is based on a dichotomy between an IT device that can be physically placed in a particular location and software, and data installed on such a device.

According to the OECD Commentary, a place of business may be established if the condition of a certain degree of permanence is met for a particular IT device, such as a server, which is given special attention in the Commentary. It is treated as part of a device that is physically located in a particular space that can be considered as a permanent establishment of a company, used to conduct business activities: the server on which the website is stored and through which it is accessible is a piece of equipment that has a physical location, and such location may, therefore, constitute a "fixed place of business" of the company that operates that server.[20]

However, with respect to the second component used in electronic commerce, i.e. software, the OECD Commentary states that an Internet website, which is a combination of software and electronic data, does not in itself constitute a "fixed place of business" through which an enterprise carries on its business.[21] Also, the fact that a website is usually visible several (tens) minutes before a transaction is made through it makes it impossible to claim that a website meets the condition of permanence in time.[22]

The OECD Commentary Guidelines can be seen as fulfilling the condition of the administrative convenience of tax rules: a server is understood as a device located in a specific space that is easy to locate and, as a consequence, it is effortless to identify the source country for the

[20] *OECD Model Tax Convention*, Commentary on Art. 5, Electronic commerce, point 123.

[21] *Ibidem*.

[22] B. Schaefer, *International Taxation of Electronic Commerce Income: A Proposal to Utilize Software Agents for Source-Based Taxation*, "Santa Clara High Technology Law Journal" 2000, vol. 16(1).

purposes of a particular tax treaty. However, the digital economic reality has changed fundamentally since the adoption of the OECD Commentary. In general, these changes can be described as a transition from the static model (based on the server-client approach) to the dynamic model, which is based on a distributed, multi-network method of communication and data transfer (referred to as the peer-to-peer model). These changes, combined with ever-increasing network bandwidth and the use of algorithms and artificial intelligence, have created a situation where a non-resident company can interact with customers and generate revenue in a market country remotely through a website or other digital means, without maintaining a physical presence in the country.[23]

The link between the conduct of several types of economic activities by non-resident entrepreneurs – based on highly digitised business models – and the need (real but not legal) to place physical assets (e.g. a server) in the market country has been loosened. This relaxation is an essential element of the OECD's conceptual work to develop cost-effective, conceptually-coherent, and internationally-acceptable responses to the specific erosion of the traditional permanent establishment status.

## 3. The "economic presence" concept as a response to the erosion of the fixed place of business permanent establishment

### 3.1. General considerations

Conceptual work on a new nexus, which, in addition to the existing institution of a permanent establishment, could apply to the business activities of companies that use computer networks to generate income in the source country without the need to be physically present there, is currently being carried out at the international level by the OECD. However, some countries have attempted to develop unilateral normative solutions on this issue on their own. One solution considered by the OECD, and already adopted in the domestic law of several countries, is the introduction of a new nexus to international legal circulation. Such a nexus would go beyond the established legal status of the enterprise based on the axiom of a "fixed place of business".

[23] OECD, *Public Discussion Draft BEPS Action 1: Address the Tax Challenges of the Digital Economy*, 24 March 2014 – 14 April 2014, https://web-archive.oecd.org/2014-03-24/271557-tax-challenges-digital-economy-discussion-draft-march-2014.pdf (accessed: 11.02.2024).

These attempts can generally be qualified as a search for a new threshold for the presence and activity of a foreign company in the economic processes of a given state, without physical (material, human) components (assets) that could be associated with such a country, without the need for traditional concepts (such as place, establishment, the duration of stay) on which the provisions of international tax law regulating the institution of an establishment are based, and which, in the conditions of the digital economy, may unintentionally make some models of market penetration by foreign entities unsuitable as a permanent establishment.

The analysis of the OECD's achievements and the solutions adopted at the national level helps to identify three basic conceptual approaches related to a "non-physical nexus": the first one focuses on technological issues and seeks a virtual link between a country and an entrepreneur; the second one is based on purely economic (business) parameters necessary to link a company with a country when income is generated without (or with little) physical presence of such a company in that country; the third approach seeks both technological and economic links between foreign companies and the market country.[24]

From the practical point of view, this different distribution of accents does not undermine a common basis of the proposed (implemented) legal solutions, such as the need for a tax test to be used primarily to study the intensity of economic ties and the degree of market penetration of an entrepreneur, i.e. a tax resident of another country. The model of foreign expansion of such an entrepreneur is based on the use of computer networks and digital technologies without (or with little) involvement of traditional assets located in the country (market) that is the target of such expansion.

Undoubtedly, the analytical work of the OECD is of key importance in this matter. It started in 1999 and continues within the framework of the BEPS project launched in 2013. Through its analytical work, the OECD has introduced into the international tax debate a problem of the efficiency and adequacy of the almost 100-year-old concept of a permanent establishment in the world of digital business models.

[24] R. Lipniewicz, *Jurysdykcja podatkowa*…, p. 375.

### 3.2. The development of the OECD analysis and concepts of economic (digital) presence

The origins of the concept of the economic presence of a company (being a resident of another country) in a given country in the context of the division of tax jurisdiction go back to early conceptual works of the League of Nations, also known as the Mexico Draft and the London Draft. According to the Mexico Draft, a company is "subject to tax on its profits in a foreign country if it has carried on its business or activities in that country, provided that such activities have not taken the form of isolated or occasional transactions". The London Draft required a company to have a "permanent establishment" in a country in order to be subject to the income tax laws of that country. It was argued in favour of the criterion contained in the Mexico Draft that some countries would lose revenue if a company were taxed on its profits in a foreign country only if it had a permanent establishment in that country.[25] It was also mentioned that forms of tax evasion could be encouraged. Indeed, some enterprises might seek to avoid taxation in a country by carrying on business there without maintaining a permanent establishment or by concealing the existence of such an establishment.[26]

According to the OECD Model Tax Convention of 1977, a permanent establishment is based on the paradigm of a fixed place of business, which still defines the limits of the tax jurisdiction of the source country in relation to the cross-border active income of enterprises. As described in section 2.2. above, guidelines on e-commerce were introduced in the OECD Commentary in 2003 in connection with the interpretation of the unchanged Article 5 of the OECD Model Tax Convention. The OECD Fiscal Committee was relatively quick to recognise the shortcomings of the server location concept adopted in 2003. It determined that a server that met the traditional requirements for a permanent establishment could be recognised as such by the source country, while a website could not. The Committee seemed to be aware of (i) changes in the business models of enterprises; (ii) the progressive dematerialisation of many elements of business processes that take place through (or even in) computer

[25] League of Nations Fiscal Committee, *London and Mexico Model Tax Conventions: Commentary and Text*, 1946, https://digital.nls.uk/league-of-nations/archive/190273348#?c=0&m=0&s=0&cv=0&xywh=-1536%2C201%2C5418%2C4016 (accessed: 11.02.2024).

[26] *Ibidem*.

networks; and (iii) the development of algorithms that allow "non-physical" digital penetration of any market by ITC enterprises to take increasingly advanced forms.

In 2003, the OECD published a draft report proposing changes to selected elements of the OECD Model Tax Convention in the context of the development of e-commerce, including a new nexus of "electronic (virtual) permanent establishment".[27] Two options were considered for a base. According to the first one (Virtual Fixed Place of Business), a permanent establishment could be created where "a company maintains a website on a server of another company located in a jurisdiction and carries on business through that website". This proposal attempted to depart from the guidelines adopted two years earlier in the OECD Commentary, according to which a website could not be considered an establishment. According to the 2003 Draft Report, "the place of business is the website, which is virtual". The OECD asserts that this alternative would effectively eliminate the need for the enterprise to have tangible property or premises within the jurisdiction. However, it would retain some or all of the other characteristics of a traditional PE, i.e. the need for a "place" (whether physical or electronic) within the jurisdiction, with the requisite degree of permanence through which the enterprise carries on business.

The second option considered in the 2003 Draft Report is an establishment test "based on local economic presence", which would not depend on the existence of a fixed place of business. According to this option, the threshold for the presence and business activity of a foreign enterprise in a given country should be analysed when an enterprise provides electronic services at the place of the residence of the customer. According to the OECD analyses, this threshold should cover enterprises that are actively engaged in business and could be based on both time and income criteria.[28] Neither option affected the provisions of the OECD Model Tax Convention or the guidance in the OECD Commentary.

The concept of an electronic (virtual, digital) PE returned in 2013 as part of the Base Erosion Profit Shifting (BEPS) project. The Task Force on the Digital Economy (TFDE), a subsidiary body of the Committee on Fiscal Affairs (CFA), was established in September 2013 to carry out this work.

[27] OECD, *Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce? Draft Report*, 2003, https://web-archive.oecd.org/2013-02-13/158922-20655083.pdf (accessed: 11.02.2024).

[28] *Ibidem*.

Its objective was to produce a report by September 2014, identifying issues raised by the digital economy as well as possible measures to address them. The TFDE held its first meeting on 29–31 October 2013, where delegates discussed the scope of the work and heard presentations from digital economy experts.[29]

In 2014, the OECD published a public discussion draft under Action 1 of the BEPS project; one option was to create an alternative nexus to address situations where business is conducted entirely digitally. Such a proposal would determine that a company engaged in certain "fully dematerialised digital activities" would have a permanent establishment if it maintained a "significant digital presence" in another country's economy.[30] Possible elements of a test for when a fully dematerialised digital activity is carried out could include: the core business of the enterprise is wholly or substantially based on digital goods or services; no physical elements or activities are involved in the value chain other than the existence, use, or maintenance of servers and websites or other IT tools as well as the collection, processing, and marketing of location data; contracts are concluded exclusively remotely over the Internet or by telephone; payments are made exclusively by credit cards or other electronic payments using on-line forms or platforms linked to or integrated with the relevant websites.[31]

Following the consultations, the definitive version of the BEPS Action 1 report presents assumptions for a new nexus based on the concept of "significant economic presence". According to these assumptions, this option would create a "taxable presence in a country where a non-resident enterprise has a significant economic presence in a country based on factors that demonstrate a purposeful and sustained interaction with the economy of that country through the use of technology and other automated tools". These factors would be combined with a factor based on income derived from remote transactions into the country "to ensure that only cases of significant economic presence are covered, to limit compliance costs for

[29] OECD, *Public Discussion Draft BEPS Action 1: Address the Tax Challenges of the Digital Economy*, 24 March 2014 – 14 April 2014, https://web-archive.oecd.org/2014-03-24/271557-tax-challenges-digital-economy-discussion-draft-march-2014.pdf (accessed: 11.02.2024).

[30] *Ibidem*.

[31] *Ibidem*.

taxpayers, and to provide certainty for cross-border activities."[32] The BEPS Action 1 Report analyses revenue-based factors, digital factors, user-based factors, and possible combinations of the revenue factor with others as potential criteria (factors) of significant economic presence.

In the Interim Report[33] published in 2018, the OECD did not present any new recommendations on the possibility of the effective use of the "fixed place of business" structure in the conditions of new digital models of cross-border business activity. The key element of the analysis was the issue of "value creation" in relation to the right to tax the income of foreign companies in the country of their market activity. The report synthesises three basic models of value creation: the value chain, the value network, and the value shop. One of the conclusions of the interim report was the increasing importance of user participation in the value creation process for some digital businesses, which could potentially be reflected in a new nexus concept for cross-border business income. This line of thinking has been criticised in the doctrine, which rightly emphasises that "the taxation of a company's income is in no way based on the value of the company";[34] the company can, therefore, "have value but no income and no income tax liability".[35]

In January 2019, based on the results of the analytical work published in the Action 1 Report and the Interim Report, the OECD proposed the adoption of a two-pillar approach, with "one pillar addressing the broader challenges of the digitalised economy and focusing on the allocation of taxing rights, and a second pillar addressing the remaining BEPS issues".[36]

In the Public Consultation Document published in March 2019, the OECD proposed a two-dimensional approach to determining the

[32] OECD, *Action 1 – 2015 Final Report: Addressing the Tax Challenges of the Digital Economy*, OECD/G20 Base Erosion and Profit Shifting Project, Paris 2015, https://doi.org/10.1787/9789264241046-en

[33] OECD, *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, Paris 2018, https://www.oecd.org/ctp/tax-challenges-arising-from-digitalisation-interim-report-9789264293083-en.htm (accessed: 11.02.2024).

[34] J. VanderWolk, *Digital Business and Corporate Income Taxation: Is Value Creation's Role Overstated?*, "Tax Notes International", 8 October 2018.

[35] *Ibidem*.

[36] See: OECD/G20 Base Erosion and Profit Shifting Project, *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note: As approved by the Inclusive Framework on BEPS on 23 January 2019*, 2019, https://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf (accessed: 11.02.2024).

minimum threshold of participation in the "economic life" of a given country, the exceeding of which would result in the source country having the right to tax revenues (or income) earned by a foreign entrepreneur who is virtually present in the source country, even though the threshold for a permanent establishment has not been exceeded. In this document, the OECD presented three proposals under Pillar One: (1) significant economic presence; (2) user participation; and (3) marketing intangibles. As the OECD points out, although these proposals have significant differences, "they all give more taxing rights to the jurisdiction of the customer and/or user" in situations "where value is created by a business activity through (possibly remote) participation in that jurisdiction that is not recognised in the current profit allocation framework".[37]

Under the "significant economic presence" proposal, a taxable presence in a jurisdiction would arise where a non-resident company has a significant economic presence based on factors that demonstrate purposeful and sustained interaction with the jurisdiction through digital technology and other automated means. According to the OECD, revenue generated on a sustained basis is the basic factor, but such revenue alone would not be sufficient to establish a nexus; only in combination with other factors would revenue potentially be used to establish a nexus in the form of a significant economic presence in the jurisdiction.[38] Factors that could economically (digitally) link digital businesses to the market country include: the existence of a user base and associated data input; the volume of digital content originating in the jurisdiction; billing and collection in local currency or with a local form of payment; the maintenance of a website in a local language; responsibility for the final delivery of goods to customers or provision by the company of other support services such as after-sales service or repairs and maintenance; or sustained marketing and promotional activities, whether on-line or otherwise, to attract customers.[39]

The "user participation" proposal would modify the current profit allocation rules to require certain enterprises to allocate profits to the jurisdictions in which their active and participating user bases are located,

[37] OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy Public Consultation Document*, 13 February – 6 March 2019, https://web-archive.oecd.org/2019-02-19/507498-public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf (accessed: 11.02.2024).

[38] *Ibidem*.

[39] *Ibidem*.

regardless of whether those enterprises have a local physical presence or not.[40] On the other hand, the concept of "marketing intangibles" addresses situations where an MNE group can essentially "reach into" jurisdiction, either remotely or through a limited local presence, to develop a user/customer base and other marketing intangibles and "see an intrinsic functional link between the marketing intangibles and the market jurisdiction."[41]

In May 2019, the OECD released another document, entitled "The Programme of Work", which explores the development of the concept of remote taxable presence (a taxable presence without a traditional physical presence) and a new set of standards for determining when such a remote taxable presence exists.[42] The OECD considered two possible courses of action: amending the definition of a permanent establishment in Article 5 of the OECD Model Tax Convention and "developing a stand-alone rule that creates a new and separate nexus, either through a new taxable presence or through a source concept."[43] According to the OECD, both potential activity directions should consider significant indicators of the MNE's remote but sustained and significant involvement in the country's fisheries economy (market jurisdiction). This would require a "threshold of sustained local revenues (both monetary and temporal) and a set of additional indicators", which, in combination with sustained local revenues, would be used to "demonstrate a link, beyond mere sales, between those revenues and the MNEs' interaction with the economy of a jurisdiction."[44]

On 9 October 2019, the OECD published the *Secretariat Proposal for a "Unified Approach" under Pillar One*, which proposed a new nexus that is "not dependent on physical presence but is largely based on sales."[45] The new nexus rule would address this issue by applying it in all cases where a company has a "sustained and significant involvement in the economy

[40] *Ibidem*.

[41] *Ibidem*.

[42] OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy: Inclusive Framework on BEPS*, 2019, https://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf (accessed: 11.02.2024).

[43] *Ibidem*.

[44] *Ibidem*.

[45] OECD, *Secretariat Proposal for a "Unified Approach" under Pillar One*, Public consultation document, 9 October 2019 – 12 November 2019, https://web-archive.oecd.org/2019-10-10/532365-public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf (accessed: 11.02.2024).

of a market jurisdiction, such as through interaction and engagement with consumers, irrespective of the extent of its physical presence in that jurisdiction."[46] According to the OECD's analysis, the main test of a company's "economic presence" in the territory of a given country should be based on the revenue criterion "as the primary indicator of a sustained and significant involvement in that jurisdiction". However, it was decided that the revenue threshold should also "take into account certain activities, such as on-line advertising services, which are directed at non-paying users in locations different from those where the relevant revenues are booked."[47]

In November 2020, the OECD published the Report on Pillar One Blueprint,[48] which confirmed the concept of a new nexus based on the criterion of income determined on the basis of the annual consolidated income of a group of companies (without yet specifying the particular amount of income), combined with the separation of foreign income falling within the scope of *de minimis*. Regarding the scope of entities covered by the Amount A mechanism, the OECD's guiding assumptions indicated entrepreneurs who are able to maintain significant and lasting interactions with customers and users in the country of their (digital) market activity (other than their country of tax residence). The new tax rules were to apply to two categories of economic activity, defined as *Automated Digital Services* (ADS) and *Consumer Facing Businesses* (CFB). The first category would include those types of activities that enable "automated and standardised digital services to a broad, global group of customers or users", and the provision of the service does not require (or requires minimal) involvement of "physical" infrastructure.[49] The second category (CFB) was aimed at activities where the profit is derived from the sale of goods and services (directly or indirectly) to consumers – both activities where physical products are produced and then sold through physical distribution channels (the so-called indirect e-commerce) and those business categories where digital technologies are used "to increase the impact and interaction with consumers at a distance."[50]

[46] *Ibidem*.

[47] *Ibidem*.

[48] OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, Paris 2020, https://doi.org/10.1787/beba0634-en

[49] M. Laskowska, *Nowe międzynarodowe reguły podziału dochodu w gospodarce cyfrowej według OECD*, "Przegląd Podatkowy" 2020, no. 12, p. 34.

[50] *Ibidem*.

The basic criterion of the new nexus should be the revenue thresholds applicable to the revenues generated by the group in a given jurisdiction, while it is assumed that they will be applied separately to each category of activity, i.e. ADS and CFB.[51]

In 2021, the OECD's approach to the new nexus concept significantly changed. In a statement published in July 2021, the OECD decided to adopt the idea of "economic presence" based only on the criterion of revenues earned by MNEs in a given country's territory.[52] According to the novel approach, "the focus on digital companies was completely abandoned and applied to all companies except financial and extractive companies."[53]

In another Statement, one issued several months later, the new nexus model based on the revenue criterion was confirmed; the OECD also presented a detailed implementation plan, according to which the mechanism known as Amount A should be implemented in the form of a multilateral convention. The acceptance of such an implementation mechanism "would establish a multilateral framework for all participating jurisdictions, regardless of whether a tax treaty currently exists between those jurisdictions."[54]

In October 2023, the Task Force on the Digital Economy of the Inclusive Framework approved the publication of the text of the Multilateral Convention implementing Amount A of Pillar 1, in which the new nexus based on the revenue criterion was finally confirmed.

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51 OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint*…, p. 65.

52 *OECD/G20 Base Erosion and Profit Shifting Project Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy*, 1 July 2021, https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf (accessed: 11.02.2024).

53 J.G. Gravelle, *The OECD/G20 Pillar 1 and Digital Services Taxes: A Comparison*, "Congressional Research Service", 1 April 2024, R47988, p. 3.

54 *OECD/G20 Base Erosion and Profit Shifting Project, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, 8 October 2021, https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf (accessed: 11.02.2024).

## 4. The concept of "economic presence" in the multilateral convention to implement amount a of pillar one

The Multilateral Convention to Implement Pillar One, Section A on Tax Challenges Arising from the Digitalisation of the Economy (MLC) is the result of the work of the OECD/G20 Comprehensive Framework on Base Erosion and Profit Shifting.[55] The basic purpose of Pillar One is to "allocate taxing rights to market economies, ostensibly recognising that sales are an important source of profit in the current digitalised economy."[56]

Adopted in the MLC as the basic element of this taxation mechanism, Amount A is part of the residual profit determined according to formulas for certain international corporations, which will be subject to reallocation among eligible (based on the new nexus) market jurisdictions. Amount A is to be calculated on the basis of consolidated financial statement data prepared by international corporations. Importantly, this new system of reallocating income among eligible taxing jurisdictions is an "overlay" on the existing system of apportioning the income of international corporations among jurisdictions based on the market price standard.[57]

The Amount A mechanism is to "replace a patchwork of digital services taxes that some countries currently levy on large technology companies based on revenue and users in their country."[58] Countries that opt in to Pillar One will be required to abolish the existing digital services taxes (DSTs) and agree not to introduce any new ones in the future.[59]

Amount A applies only to MNEs with global revenues in excess of 20 billion EUR and total profits in excess of 10% of their global revenues

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[55] OECD, *Explanatory Statement to the Multilateral Convention To Implement Amount A of Pillar One: Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy*, 2023, https://www.oecd.org/tax/beps/explanatory-statement-multilateral-convention-to-implement-amount-a-of-pillar-one.pdf (accessed: 11.02.2024).

[56] A.P. Dourado, *Would Pillar One Fix the Broken System?*, "Intertax" 2023, no. 12, p. 809.

[57] M. Laskowska, *Nowy mechanizm administrowania CIT na poziomie globalnym. Nowe podejście do administrowania globalnym rozliczaniem podatku dochodowego w świetle projektu OECD Filar I*, 2023, https://casp.sgh.waw.pl/blog/nowy-mechanizm-administrowania-cit-na-poziomie-globalnym (accessed: 11.02.2024).

[58] A.N. Michel, *Bold International Tax Reforms to Counteract the OECD Global Tax,* Policy Analysis no. 968, Cato Institute, Washington, 13 February 2024, p. 10.

[59] R. Mirembe, *Filar pierwszy: jest porozumienie! Kto na nim skorzysta?*, "Analizy i Studia CASP" 2023, no. 1, p. 45.

(the revenue threshold will be lowered to 10 billion EUR subject to successful implementation as determined by a seven-year review). It allocates 25% of the MNEs' excess profits (i.e. group profits in excess of 10% of revenues) to the jurisdictions in which the MNE generates its revenues (market jurisdictions). This allocation is adjusted or eliminated to the extent that the market jurisdiction already taxes the MNEs' excess profits outside the MLC.

The determination of whether a market economy jurisdiction is entitled to tax A profits is based on the quantitative threshold of revenues in excess of 1 million EUR, reduced to 250 thousand EUR for jurisdictions with the GDP of less than 40 billion EUR, regardless of the MNEs' physical presence.[60] The nexus test is applied on the basis of the income earned by the MNE group without the need to identify a specific entity from which the income is derived.[61] The adopted thresholds are intended to ensure that the nexus test is met only when the amount of revenue of an MNE group treated as arising in a market jurisdiction is material.[62]

Introducing a new nexus into the international tax regime based solely on the criterion of revenues generated by MNEs in the territory of individual countries raises certain doubts.

First of all, the "traditional" permanent establishment test is so universal that, despite the passage of time, it is still considered appropriate for taxing many manifestations of cross-border business expansion. The "fixed place of business" axiom does not refer to quantitative criteria and focuses on the material aspects of the supply side of business activity. The turnover threshold for the non-physical economic presence and activity of a foreign company in the source country changes this paradigm by focusing on the demand side of the company's activities. In the case of a new nexus, the extent and intensity of the company's involvement of physical assets in the market jurisdiction is irrelevant; the key factor is the extent of its market exploration, expressed in terms of the amount of revenue generated in a given market. The OECD has not decided to introduce any (sub)criteria, e.g. a minimum number of contracts concluded or customers

[60] OECD, *The Multilateral Convention to Implement Amount A of Pillar One, Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, Overview, October 2023, pp. 3–6.

[61] OECD, *Explanatory Statement to the Multilateral Convention To Implement Amount A*…, p. 83.

[62] *Ibidem*.

(users) in the territory of individual market expansion countries, which was envisaged by the EU in its projects.[63]

The OECD justifies this approach by wishing to reduce compliance costs for companies engaged in international economic activity; the fewer criteria to be met, the lower the additional costs of verifying their application.[64] From this perspective, the adoption in the MLC of a simple criterion of turnover achieved by international enterprises as a new nexus for the countries in which they are economically-active, regardless of the size of locally-involved assets, can be considered as meeting the requirement of minimising compliance costs for enterprises.

Another argument in favour of using the income criterion is that using the net income criterion instead of the gross income criterion could distort the distribution of tax claims between countries, as the territorial link between the generation of revenue and the incurrence of tax-deductible costs is much looser than in traditional industries. For many digital business models, costs may be incurred in a country other than the country of revenue; the geographical allocation of costs to revenues may be problematic.

On the other hand, it is legitimate to ask whether revenues from the country to which a foreign company exports goods or services without involving local physical assets can be qualified as the location of the source of such revenues. It should be agreed that a supplier of goods (services) is not involved in the economic life of a country merely because goods or services are imported into that country. The goods or services "may become part of the economic circumstances there, but not the supplier or its business."[65]

Under the new Pillar One system, as a consequence of meeting the revenue nexus test in the market jurisdiction, the allocation of part of

[63] See: Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, Brussels, 21.03.2018, COM(2018) 147 final, https://data.consilium.europa.eu/doc/document/ST-7419-2018-INIT/en/pdf (accessed: 11.02.2024).

[64] OECD, *Explanatory Statement to the Multilateral Convention To Implement Amount A…*

[65] OECD, *Public consultation on the tax challenges of digitalisation – Comments by Bombay Chartered Accountants' Society on the OECD's Public Consultation Document 'Addressing the Tax Challenges of the Digitalisation of the Economy'*, 6 March 2019, https://web-archive.oecd.org/2019-06-06/506501-public-consultation-tax-challenges-of-digitalisation-13-14-march-2019.htm (accessed: 11.02.2024).

the profits to be taxed in that country will take place even for traditional B-to-B industries (e.g. steel industry) "that have little connection with the marketing and other activities and are not considered to create value in the market jurisdictions", which, according to T. Kamiya, "deviates from the source principle, which is the idea of taxing where value is created."[66] The new sourcing rules assume that "sales factor formula apportionment can work even if the rules apply only to a small number of companies, to a portion of their profits, and even if those companies do not really know where their end customers are located."[67]

Shifting taxation to countries with an economic presence – determined on the basis of sales nexus – can "benefit countries with a large domestic market and many consumers, to the detriment of smaller exporting economies."[68] According to D. Bunn, "if a jurisdiction has a large market, it is likely to benefit from the Amount A rules. If a jurisdiction has businesses with very high profit margins, it is likely to lose taxable profits."[69] On the other hand, the adoption of a nexus test based on the turnover threshold could incentivise multinational groups to withdraw from relatively "small, low-margin markets altogether, where the tax and administrative burdens of this proposal could outweigh the benefits of being in the market at all."[70]

[66] T. Kamiya, *NexusPillar 1: The Aim of "Fair" Distribution of Profits and Taxing Rights among Countries*, [in:] *Justice, Equality and Tax Law*, eds. N. Čičin-Šain, M. Riedl, Wien 2022, p. 152.

[67] See: D. Bunn, *Response to the United States Treasury Department's Request for Public Input on Pillar One*, 2023, https://taxfoundation.org/research/all/federal/treasury-public-input-pillar-one-response/ (accessed: 11.02.2024).

[68] OECD, *Public consultation on the tax challenges of digitalisation – Comments by the Chambre des salariés Luxembourg on the OECD's Public Consultation Document 'Addressing the Tax Challenges of the Digitalisation of the Economy'*, 4 March 2019, https://web-archive.oecd.org/2019-06-06/506501-public-consultation-tax-challenges-of-digitalisation-13-14-march-2019.htm (accessed: 11.02.2024).

[69] See: D. Bunn, *Testimony: The OECD's Pillar One Project and the Future of Digital Services Taxes*, 7 March 2024, https://taxfoundation.org/research/all/federal/pillar-one-digital-services-taxes/ (accessed: 11.02.2024).

[70] OECD, *Public consultation on the tax challenges of digitalisation – Comments by EBIT on the OECD's Public Consultation Document 'Addressing the Tax Challenges of the Digitalisation of the Economy'*, 6 March 2019, https://web-archive.oecd.org/2019-06-06/506501-public-consultation-tax-challenges-of-digitalisation-13-14-march-2019.htm (accessed: 11.02.2024).

## 5. Concluding remarks

The doubts raised in this article mean that the adoption of a new nexus based on the concept of non-physical "economic presence" as a new nexus based on a revenue test may face difficulties. First of all, the proposal in the Multilateral Convention to Implement Amount A of Pillar One nexus based solely on the criterion of income earned by enterprises engaged in cross-border activities means that the new tax mechanism will also cover traditional enterprises (which, of course, meet the qualifying criteria) that export "physical" goods to other countries. This seems to be a distortion of the idea behind the introduction of the OECD's two-pillar approach, which was to create a mechanism that would allow source countries to tax those companies whose innovative, digital business models in many cases do not meet the classic nexus based on the "fixed place of business" criterion and do not lead to the creation of a permanent establishment.

The OECD's model for the development of international tax law also raises doubts from the perspective of simplicity and transparency. The OECD's activities lead to the introduction of either modification mechanisms (the Multilateral Convention to Implement the Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting) or "overlays" (the Multilateral Convention to Implement Amount A of Pillar One) in relation to the international tax regime that has been operating for several decades, based on a global network of bilateral tax treaties. Despite the proposed mechanisms to ensure tax certainty, this creates additional areas of tax risk for international companies and, as a result, increases compliance costs.

From the tax policy perspective, the fact that Amount A "reflects Europe's concern about the ability of US «big tech» to sell directly to 300 million wealthy European customers"[71] explains the still cautious stance of the United States of America on this mechanism.[72]

In this context, a solution that would not turn the international tax system into an increasingly complex set of juxtaposed and interacting (sub-)regimes, and at the same time could reduce "tax tensions" between

[71] G.S. Cooper, *Building on the Rubble of Pillar One*, "Bulletin for International Taxation" 2021, no. 11/12, p. 534.

[72] R. Avi-Yonah, A. Kir, *Building the Gateway: Why the Two Pillars Need Each Other*, "U of Michigan Public Law Research Paper" 2024, no. 24-023, https://ssrn.com/abstract=4766111 (accessed: 11.02.2024).

countries participating in the OECD's comprehensive framework, could be to propose in the OECD Model Convention (which remains the main model for negotiating bilateral tax treaties) a new type of a permanent establishment based on the concept of a "digital place of business". Such a solution could be based on an analysis of the scale and scope of the involvement of intangible assets and/or "digital reach" to users/customers in the source country. In the case of many digital business models, the data collected from a given market is processed and monetised in another country, which – if the Amount A mechanism is adopted – may result in a country with a significant number of users (customers) of a foreign company that generates significant value (by processing data collected from users/customers) not having any right to tax income under the Amount A mechanism. This may be because the income from the value (data) generated on the territory of such a country is "converted" into income in another country, and if the income nexus is met in that country, the international company will be obliged to allocate part of the profits for taxation there.

Extending the scope of the application of the permanent establishment concept to digital business models of companies can, therefore, be an alternative to the new additional mechanism for the taxation of income from cross-border activities, called Amount A, proposed by the OECD.

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