

# Permanent Establishment for Ecommerce in International Taxation

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## 要 旨

インターネットと電子商取引の急速な発達の世界で非常に多くの変化をもたらした。電子商取引は商取引をより速く、より容易に、そしてより安全にした。他方で、税務当局はこの新しい形の商取引から来るいくつかの問題に直面している。国際課税上での恒久的施設はその問題のうちの1つである。電子商取引において、物理的な存在、固定された場所および人間の介在はもはやビジネス上で必要ではなくなっている。したがって、租税条約モデルには変更と修正が必要である。これまで電子商取引の中の恒久的施設の問題を解決するために多くの調査や研究がなされている。この論文は、1920年前半の恒久的施設の基本的概念を検討することにより、電子商取引課税の基礎的な問題を研究したものである。「経済への貢献」の概念(それは恒久的施設の基本概念である)は、今までどおり現代のインターネット時代に適用することができる。しかしながら、特に主体性や買い手と売り手の場所が分からない場合、恒久的施設に対する包括的な解決を見つけるのは難しい。中間段階の機関が電子商取引の課税を管理するために必要である。

**Keywords:** ecommerce taxation, permanent establishment, international taxation

## 1. Introduction

The tax treaty between two countries has three goals. The aims are: to avoid double taxation, to avoid non taxation and to allocate the appropriate tax revenue between host and home country from multi national companies. One of the methods to avoid double taxation is permanent establishment. According to United Nations Model Double Taxation Convention between Developed and Developing Countries, Permanent Establishment (PE) means a fixed place of business through which the business of an enterprise is wholly or partly carried on. According to this concept, contracting countries has the right to tax the foreign company

only if the foreign company maintains the PE and only profit attributable to that PE is taxable. The concept of Permanent Establishment (PE) is the main component of the tax treaty between countries. “No PE no tax” becomes a popular jargon in international taxation matters.

The concept of PE itself was first stated in the early model conventions of the League of Nations in 1928. League of Nations Draft Model Treaty (1928) Ic, article 3, said that “Income derived from any industrial, commercial or agricultural undertaking and from any other trades or professions shall be taxable in the State in which the permanent establishments are situated.” It means that PE had been playing an important role in the same time as the tax treaty model was developed.

Under the PE principal, both countries involved in tax treaty could avoid double taxation. How could it be done? When two countries reached the agreement in tax treaty, usually the source country agreed that it would not tax profit resulting from a nonresident’s business unless this nonresident maintained a PE within the border of the source country and the residence country also agreed to give a tax credit for the tax paid to the source country. In other word, when nonresident had no PE then no tax must be paid. Some examples of PE were stores, offices, branches or factories. Additionally, the definition of PE excludes the activities that are merely preparatory or auxiliary in nature such as maintenance of warehouse to store goods.

Ever since the early until the late of 20<sup>th</sup> century, many countries had used the concept of PE in their tax treaties to avoid double taxation. Some problems and challenges appeared in the early 21<sup>st</sup> century when the Internet era changed the way of living to many people. The development of Internet during the past decade had brought some changes in the world’s society. The changes were not only in the way of working but also in the way of doing business. When it came to ecommerce business in the past decade, people said that the business had changed from the brick and mortar companies to the online stores, in other word, from the companies that have physical presence to companies that have Internet-only presence.

The ability of Internet technology to do business solely in virtual world gave some advantages for business society. Cutting the chain of distribution, saving the cost for advertisement, warehouse, employee and enhancing the number of clients’ worldwide were some of the advantages from doing ecommerce business. In extreme case, a person with a computer equipment and Internet connection from his/her room can startup a small business easily and market his/her products to anywhere around the world. On the other hand, ecommerce business had brought problems within the taxation matters. The tax authority worldwide recognized those problems at the same time as Internet technology emerged. One of those problems was caused by the permanent establishment in international taxation. This new technology had also changed the

concept of PE.

This paper tries to explore the real problem of PE regarding ecommerce business. Part 2 briefly reviews the historical background and development of PE since the first time written in League of Nations Draft Model until the last model of UN and OECD. The historical background is essential in order to obtain the basic idea of PE. Though the PE concept has been developed from time to time, the basic principle of PE has not change over the years. By looking back to the early stage of PE and also its development, it would be easier to find some symptoms why PE became a problem when dealing with ecommerce. From that point of view, it will continue with the basic nature of ecommerce and how it differs from traditional commerce in part 3. Underlying problems regarding PE in ecommerce are also discussed in this part. Since such problems were found almost a decade ago, a lot of studies and researches have been done by scholars. With the purpose of finding the red line between many solutions, this prior studies and researches will be presented in part 4. Analysis and ideas are offered in part 5 and the last part is the conclusion.

## **2. The Historical Background of Permanent Establishment**

### **2.1 League of Nations Draft Model Treaty (1928)**

Prior to the League of Nations Draft Model Treaty in 1928, there were several works by the experts appointed by Fiscal Committee of League of Nations. In September 1921, the Financial Committee of the League of Nations decided to ask four economists to prepare a report about the study of double taxation. The four economists were Prof. Bruins (Commercial University, Rotterdam), Prof. Senator Einaudy (Turin University), Prof. Seligman (Columbia University, New York) and Sir Josiah Stamp (London University). After exchanging views by correspondence, the experts met in Geneva in March 1923 and published the report to the Financial Committee<sup>1</sup>.

The four economists rejected the old theory of taxation which had been related to the philosophical basis of society in the “social contract” according to the principle of exchange as between the government and the individual. The two theories were cost theory and benefit theory. The cost theory was the tax to be paid to the government for the cost of the service performed by the government. The benefit theory was tax to be paid in accordance with particular benefits conferred upon the individual. Neither of those theories was fit to solve the problem of double taxation.

As still being debate till nowadays, in their report, the four economists analyzed the problem connected to

the choice of either residence or source as the basis for tax jurisdiction and came to the conclusion that a doctrine of economic allegiance was theoretically most reasonable. This doctrine was given quantitative expression by reference to term economic faculty or ability of the individual to pay. That is to say, the taxes eventually fall upon persons and ought to fall upon them in the aggregate according to the total resource of the individual, leading to progressively larger sums being paid by the people who are richer.<sup>2</sup>

There were also two important questions raised by these experts: where was the yield physically or economically produced and where was the wealth spent or consumed or disposed? In other word, the two main points were the origin of the wealth and the domicile of the owner who consumed the wealth. In their opinion, the origin concept was applicable in the case of land, commercial, industrial and agricultural establishments (immoveable property). In contrast, the moveable property, such as transferable securities, general credits and personal earnings, was better suited with the domicile concept.

One year after the four economists' task begun, in June 1922, the Financial Committee of League of Nations decided to call in a number of experts on fiscal matters to examine from administrative and practical point of view both the problem of double taxation and tax evasion. The experts consisted of group of officials of the fiscal administrations from various countries. The report was submitted by the experts to the Financial Committee on February 7<sup>th</sup> 1925<sup>3</sup>.

In their report and resolutions, the experts divided the double taxation measure into two parts. First part was for impersonal or schedular taxes and the second part were for personal or general income tax. For scheduler tax, the experts came to the conclusion that only State in which the source of income situated was entitled to impose scheduler taxes.

These principles were applied to various incomes such as: immoveable property (land, buildings), agricultural, industrial and commercial establishments. The taxes on the actual or presumed rental value should be levied by the State where the property was situated. For the mortgages, the right to levy a scheduler tax was the State where the immoveable property was located. In short, the source/origin principle was applied in this matter.

For personal or general income tax, the experts believed that it should be imposed only by the State of domicile. If the tax in origin country occurred, in bilateral convention between two countries, it should be taxed only a portion of the income arising in the origin country and the other portion being taxed in the State of domicile of the taxpayer, but at the rate applicable to his total income from every source. It may be stated as a general conclusion that the report and resolutions favored the principle of residence.<sup>4</sup>

The experts in their Report and Resolutions of 1925 suggested that their committee should be enlarged and that it should be requested to prepare preliminary draft conventions on the basis of their resolutions.<sup>5</sup> The Financial Committee approved that recommendation and continuous report was presented to the League in April 1927. As before, the experts divided all direct taxes into two classes: impersonal and personal taxes. But the decision of category of each class was left to each of the contracting states. The experts suggested that impersonal tax should be taxed by the country of origin while personal taxes should be done on residence or domicile basis.

According to the report, for personal tax, in order to avoid double taxation for personal taxes, the state of domicile would make a deduction from its personal tax with regard to the income taxed in the country of origin. This deduction was to be the lesser of two amounts: the amount of the tax which would be paid in the state of domicile exclusively on such part of the income as was liable to taxation in the state of source or the amount of the tax actually paid in the country of source.

In 1928, the Council of the League of Nations organized a General Meeting of Government Experts in 1928 for discussion of the Committee Report of 1927 which resulted in three drafts of bilateral conventions. Draft Bilateral Convention Number Ia divided the contracting states of direct taxes into two: impersonal and direct taxes. Impersonal taxes were collected by the country of source and personal taxes by the country of residence. The double taxation was avoided by deducting the expense at the country of residence. Meanwhile, Convention Number Ib and Ic gave no distinction between personal and impersonal taxes for the direct taxes of contracting states. In principle, income should be taxable by the state of domicile or residence. In different way, income from immoveable property, industrial, commercial or agricultural undertaking, salaries, wages or other remuneration except salaries of official and public employees serving abroad were taxable by the state of origin.

Article 5 Convention Number Ia, Article 2 Convention Number Ib and Article 3 Convention Number Ic, stated that income, from any industrial, commercial or agricultural undertaking and from any other trades or professions should be taxable in the State in which the permanent establishments were situated. The permanent establishment included: the real center of management, branches, mining and oilfields, factories, workshops, agencies, warehouses, offices and depots. If the international business was conducted through a bona-fide agent of independent (broker, commission agent, etc), that independent agent could not be regarded as permanent establishment. In the case of undertaking had two permanent establishments in both countries, each of the two states should tax the income produced in its territory and both countries should arrange the

basis of apportionment on the tax. Nevertheless, income from maritime shipping and air navigation concerns should be taxable only in the State in which the real center of management was located.

## **2.2 Mexico Draft (1943) and London Draft (1946)**

In 1931 the Fiscal Committee of The League of nations submitted the report on their work of the third session of the committee. There was no substantial modification of the relationship affected by the report of 1927 and 1928 between the alternative principles upon which tax jurisdiction depended. However, there was some evidence of increased acceptance of the principle of residence in this convention.<sup>6</sup>

In their report to the Council on the fourth session, the Fiscal Committee drafted the convention model in 1933. The convention was mainly concerned with the problem of allocation but repeated the preference for the principle of residence. Article 1 of the report stated that “an enterprise having its fiscal domicile in one contracting state shall not be taxable in other contracting state except for income directly derived from sources within its territory and to a permanent establishment situated in such state”. That model convention was revised in 1935 but never formally adopted.

In this convention, permanent establishment was treated as if it was a separate enterprise and was determined its income based on the arm’s length standard.<sup>7</sup> According to this convention, country was allowed to determine the income of a PE based on the local books of account, without reference to the books of the entire firm. This approach was a remarkable change from the 1928 model convention.

In 1940, the Fiscal Committee had a meeting in the Netherlands to review the progress of tax treaties since 1928 Draft convention Model. In 1943, the committee held a conference in Mexico City to continue revising the 1928 model. The meeting included representatives from countries of the Western Hemisphere, both developed and developing (Argentina, Bolivia, Canada, Chile, Colombia, Ecuador, Mexico, Peru, the United States, Uruguay, and Venezuela). The regional conference produced a draft model convention known as the Mexico Draft.

In the Article 4 of Mexico Draft, it was stated that if an enterprise or an individual in one of the contracting States extend its or his activities to the other State, through isolated or occasional transactions, without possessing in that State a permanent establishment, the income derived from such activities shall be taxable only in the first State. If an enterprise has a permanent establishment in each of the Contracting States, each State shall tax that part of the income which is produced in its territory. That article was a notable changed from 1928 draft convention to clarify an ambiguity in the 1928 convention by providing that all of

the business income derived in a country would be taxable there unless the activities were “isolated or occasional” and the enterprise earning the income did not have a PE in that country.<sup>8</sup>

Unlike the Draft Model 1928, the Mexico Draft favored to the source principle instead of residence principle. Several kinds of income such as; real property (article III), mortgages on real property (article III), commercial or agricultural business and from any gainful activity (article IV), compensation for labor or personal service (article VII), public pensions (article VIII), income from moveable capital (article IX), were taxable on at source.

In their tenth meeting session meeting which was held in London (March 1946), the Fiscal Committee of the League of Nations reviewed and redrafted the Mexico draft. Although the committee considered the convention model was similar to Mexico model, some changes were made in the wording and some provisions were canceled due to double mentioning in other clauses.

In the case of PE, the wording of convention of Article IV was changed into “Income derived from any industrial, commercial or agricultural enterprise and from any other gainful occupation shall be taxable in the State where the taxpayer has a permanent establishment.” Also the word “isolated or occasional” in paragraph two in the same article was suppressed.

### **2.3 OECD Model**

When the Fiscal Commission of United Nations, which was under the Economic and Social Council of the United Nations, and its Committee on International Tax Relation were halted in 1954, the development of tax treaty during that day was led by Organization for European Economic Cooperation (OEEC) and later on became the Organization for Economic Cooperation and Development (OECD).

The Council of OEEC adopted its first recommendation concerning double taxation on 25 February 1955; which subsequently resulted in the establishment of the OEEC Fiscal Committee in March 1956. In July 1958, the Fiscal Committee was instructed to prepare a draft convention for the avoidance of double taxation with respect to taxes on income and capital as well as concrete proposals for the implementation of such a convention

The first OECD Model Double Taxation Convention on Income and Capital was published in 1963. The model drew heavily from the London Draft of League of Nations.<sup>9</sup> In 1967 the Fiscal Committee of OECD began to revise the 1963 “Draft Double Taxation Convention”. That revision “was considered necessary in order to take account of “experience gained by Member countries in negotiating new conventions or in their

practical working” and also of “the changes in systems of taxation and the increase in international fiscal relations on the one hand and, on the other, the development of new sectors of business activity and the increasingly complex forms of organization adopted by enterprises for their international activities”. The revision of the 1963 Draft Convention ultimately led to the publication of the 1977 “Model Double Taxation Convention on Income and on Capital”. It had recently undergone revisions in 1992, 1994, 1995, 1997, 2000, 2003 and 2005.

The OECD model was very effective to eliminate most of the problem from double taxation, however, several core features from OECD model had promoted international under taxation.<sup>10</sup> In order to curtail tax avoidance and evasion, OECD model provided an exchange of information from contracting states regarding taxation matters.

Regarding PE, one of the features of the OECD model was the treatment of affiliate entities. Under this model convention, a member of multi national company group would not constitute PE in a country solely because it conducted its business in that country through a related company.<sup>11</sup> It meant that affiliate relationship had nothing to do in determining whether that affiliate was the PE of the multi national company or not. To constitute a PE of that multi national company, the affiliate must be an agent of the group and make a contract on behalf of the group. As a result, the multi national company was able to restrict the profits taxable in the source country to some modest return on its physical assets located in that country.

## **2.4 UN Model Convention**

The group of Experts on International Cooperation in Tax Expert (Group of Expert) for United Nations prepared a Manual for the Negotiation on Bilateral Tax Treaties Between Developed and Developing Countries and it was published by United Nations in 1979. Formally, in 1980, the United Nations published the United Nations Model Double Taxation Convention Between Developed and Developing Countries which included a model convention and commentary.

This model was based on OECD model. On the other hand, it represented the compromise between the source principle and the residence principle, although it gave more portion to the source principle than did the OECD model.<sup>12</sup> Since most of the members of United Nations were the capital importing countries, it was very well understood that the weight of favor was given to the source principle.

Regarding PE, the UN model reaffirmed early model convention from the League of Nations model treaty with some addition of the introducing of the new concept of “fixed base”, to be used in the case of

professional services or other activities of an independent character. The model also added some business characters to be taxed in the source country in the appearance of PE. That business category was assembly project as and addition of installation project and also supervisory activities in connection of with “a building site, a construction, installation or assembly project”.<sup>13</sup>

During the Eight Meeting of Group of Experts, it established a Focus Group in order to revise and update the UN Model of 1980. In their meeting in New York (1998) and Amsterdam (1999), the Focus Group discussed the comments and suggestions from member of the Group of Experts on the articles and commentaries of the UN Model Convention. The comments and suggestions from members of the Group of Experts on these editorial changes were examined by the Steering Committee in its New York meeting which was held in April 2000, and the final text of the UN Model Convention was adopted on a consensual basis by the Steering Committee. After being approved by the members of the Group of Experts, the final version of the United Nations Model Double Taxation Convention between Developed and Developing Countries was published by the United Nations in 2001.

As the conclusion, the concept of PE was some kind of trade-off between source and residence principle for taxing multi national company. The concept of PE which is used by OECD in current day was first introduced in the draft prepared by Fiscal Committee of OECD in 1958 in their draft convention for the avoidance of double taxation. However, although different in wording, that PE concept, in principal, was taken from the UN model in 1928. The UN model was also applied to the same principle of PE from OECD with some modification in order to fit the need of their members in the capital importing country. The concept of PE has not changed significantly over the years.

### **3. The Underlying Problems of PE Regarding Ecommerce**

As mentioned before, an individual in his room with a connection to the Internet could startup a small business in the Internet and published his homepage which could be accessed worldwide 24 hours a day anywhere without jurisdiction border. This kind of business was very popular during the boom of dot.com in late 19<sup>th</sup> century, at the same time as the Internet development, until nowadays. This type of business not only shifted old model of business to online business but also created new kinds of business in the Internet and made many fortunes for the people involved. Some examples of those new types of business are online sales of digital products (services, books, movies, music, pictures, etc), electronic banking, electronic money, etc.

At the same time as the ecommerce business was growing, tax authorities in the world was studying the problems that might appear from ecommerce regarding taxation matter. The main understanding of the studies is how to make revenue from ecommerce and in the same time still gives the beneficial condition in order not to restrain the development of ecommerce. From many problems of taxation in ecommerce, this chapter will focus on PE problem as a base to give the right to tax for one country.

### **3.1 The Nature of Ecommerce Business**

Many definition of ecommerce has been given in the study and the most important structure of that definition is that the transaction is conducted through the computer by the means of network. Originally, the ecommerce was introduced for the transaction electronically using Electronic Data Interchange (EDI). In this system, the transaction was done over the network within two persons or companies in which they agreed to sell or buy by computer-to-computer using the standard messaging. With the establishment of World Wide Web concept, the definition of ecommerce changed into the purchase of goods and services over the Internet.

There are many distinctions between traditional commerce and ecommerce. First of all is the physical existence of traditional commerce. It has physical existence that can be seen in the shape of store, office, outlet, storage or factory. While ecommerce does not have such existence, it only appears in the shape of web site or homepage and several links. Practically, many online businesses don't have any store, office or storage in their place. As the matter of fact, this is one of the advantages of ecommerce. The physical existence of ecommerce itself is the set of programming module located within the computer which is connected to the global network. The set of program and computer can be put anywhere world wide as long as linked to the Internet.

The second factor is goods or services sold / buy. In traditional ecommerce, client who wants to purchase goods or services can take a look at those things in real while in ecommerce they are represented in the form of still or motion pictures and set of information in its website. For ecommerce, the fact that the customers do not have to go to the shop for buying things is easier; does not mean ecommerce has advantage to traditional commerce in this point of view. Some customers find it more convenient and secured to see the real stuff they want to buy. In this factor, ecommerce has also created the new kind of good called digitized products. This product can only be sold and delivered through ecommerce.

The third factor is the seller and buyer of the transactions. Traditionally, seller and buyer have to meet face to face to facilitate the deal. In the form of retail store, the buyer at least meets the cashier in order to pay

what they buy. This is not the case when the transaction is done online. In some circumstances, buyer and seller do not even know each other. In extreme case, buyer or seller in ecommerce is only machine equipment which runs automatically. The similarity of traditional and electronic commerce in this factor is when it comes to the big and complicated transaction. Then, the people involved indeed still need to meet each other.

The fourth factor involved is the payment of transaction. All payment devices in traditional commerce are acceptable in ecommerce. Money, check, credit card and bank transfer are the example of payment devices for traditional commerce. However, cash money is rarely used in ecommerce. For ecommerce, payment devices depend on the agreement before transaction. Internet also originates the used of electronic or digital money as the payment device.

The fifth factor is the world wide customers. Unlike conventional commerce whose customers are limited by geographical border, ecommerce can do business online and reach customers all around the world. The Internet gives the possibility for ecommerce to find customers from a person, companies, governments or any institution in anyplace at anytime.

Book keeping is the sixth factor of transaction. After finishing the payment process, buyer or seller keeps the record of their transaction. For traditional commerce, invoice and receipt are still the main important evidences to be recorded in the book of account. While ecommerce can do the same work automatically and can be done online promptly.

There are many other factors which make traditional and electronic commerce distinct. However, it is not purely in the essence of basic factor. One of them, convenience factor, has already mentioned in the preceding paragraph. The other factor is security of commerce.

From factors described above, all factors have the tendency of creating problem for taxation matter. Meanwhile, regarding problem in PE, the physical existence of ecommerce is the most important factor followed by the person (seller / buyer) or the company involved and the world wide customers.

### **3.2 PE in Ecommerce**

In this section, the PE concept before modification or amendment of PE regarding ecommerce business will be studied to get a basic understanding from the problem of PE in ecommerce. Some studies including modification of the latest model convention model will be discussed in the next chapter.

According to OECD and UN<sup>14</sup> model tax convention article 5 paragraphs 1, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly

carried on. There are three main points of that article, which are: place of business, fixed place, the right of use for place of business.

Commensurate to Commentary of paragraphs 1 on article 5 UN Model, the term ‘place of business’ covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose. A place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal.<sup>15</sup> Some examples for PE are included in the paragraphs 2: a place of management, a branch, an office, a factory, a workshop; and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

By looking at the nature of place of business for ecommerce, there are two kinds of appearance for doing such kind of business. The first is the web site by which the clients / customers doing the transactions and the second is the server / computer by which the web site is located. In the preceding sub chapter, this appearance is said as physical existence. The ambiguity for the place of business for ecommerce could make a problem if it is not clearly define in the tax treaty.

Another problem might appear even after the place of business is determined. Though either the server or website has been chosen as the place of business, the difficulty of knowing the exact location of the server might give dispute to the contracting state involved. In the global network, identity of the dealer, represented in web site or server, is not easy to classify. The tax authority needs to cooperate with other institutions in order to get such information.

Another point in constructing PE is the concept of fixed place. In the normal way, there has to be a link between the place of business and a specific geographical point. However, it does not mean that the PE has to be fixed to the soil. In OECD commentary, it is written that equipment constituting a place of business does not have to be fixed to the soil on which it stands, it is enough that it remains on a particular site. The term “fixed” in here has two categories: location and permanence (duration of time). As stated in the commentary, it is also followed by that a permanent establishment can be deemed to exist only if the place of business has a certain degree of permanency, i.e., if it is not of a purely temporary nature. In other word, in order to fit the “fixed place”, the place needs to be located at certain place for a satisfactory period of time.

As mentioned before, for some reasons, the physical location of the server / web site cannot be found easily. In addition, web site is very mobile. It can move from one place to another depending on the requirement mostly the Internet infrastructure. The server itself is just machine equipment that keeps

developing from time to time as the technology trend grows. Practically, the server's location is mostly decided not because of the customer's location but depends on information technology infrastructure which supports the efficiency and convenience for customers.

The period of time would not be a problem in determining the fixed place of business for ecommerce. As long as the operation is carried out on a regular basis, it will constitute a permanent establishment. The same with traditional commerce, the PE in ecommerce will be considered close when all acts and measures connected with the former activities of the permanent establishment are terminated.

The last point of PE is the right of using the place of business. In the commentary of UN model, a place of business may exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. It is immaterial whether the premises, facilities or installations are owned or rented. It means that as long as the person has the right to use a certain place, by using their own place or using other enterprise's place, it can constitute permanent establishment.

In practice, many ecommerce businesses are done by using other machine equipment, server to be exact, either by leasing or renting some spaces of hard disk in the server. One server can have a lot of spaces that can be rented to others. In this case, that server is similar to the premises that consist of rooms, cubicle, floor or space which could be rented partially or wholly to others. Though the right of use principle for PE in ecommerce looks simple, problem might occur when it comes to the person involved.

Unlike traditional PE, the presence of people in the server is not required. The owner could run the web site remotely and automatically from a long distance. Principally, the commentary of UN model has discussed this matter by comparing it to the gaming or vending machine set up by an enterprise in other state. However, tracing the location of server is yet another problem of the authority. Also, unlike, gaming or vending machine whose customers are limited in geographical surrounding, the customers of ecommerce are worldwide. It could create difficulties to determine which jurisdiction country has the right to tax.

#### **4. The Studies and Development of PE For Ecommerce**

“It is not easy to determine proper place of taxation if a manager of an estate in Java island may be said to be the directing brain living in Java, and some of the rights relating to that estate may be enforceable in Java; on the other hand, the final control and direction may be in the hands of directors in Amsterdam; finally, the actual recipient of part of the profits may be a shareholder in London.”

That example was given by the four economists report on double taxation submitted to the financial committee of League of Nations in 1923. It showed that the problem of international taxation had been considered since many decades ago by tax experts.

In the same time of Internet era, particularly the rapid development of ecommerce, scholars have begun to realize this new technology will affect tax system. Many working papers, studies, books and research have been done in order to create the same understanding about taxation on ecommerce. From many of them, only studies about PE in ecommerce will be discussed.

#### **4.1 Efforts by OECD**

It would be unfair if we do not consider OECD as the pioneer of ecommerce taxation's study and research. The first attempt was conducted in their meeting to discuss cross border of ecommerce challenge in Turkey, Finland. The following year, October 1998, an OECD ministerial meeting on ecommerce called "A Borderless World – Realizing The Potential of Global Electronic Commerce" was conducted in Ottawa, Canada. The well known Taxation Framework Condition for Ecommerce or Ottawa Taxation Framework was established. The OECD Committee on Fiscal Affairs set up the principle of taxation for ecommerce, which were: neutrality, efficiency, certainty and simplicity. These principles were similar to the ones of traditional commerce and should be applied equally to ecommerce. In addition, new measures should be directed toward the application of existing taxation principle.<sup>16</sup> To continue the further study and develop ideas for implementing from Ottawa meeting, OECD established Working Parties (WP) whose members were made up from government officials.

One year after Ottawa framework, WP published the first draft for comments on the proposed clarification of the commentary on article 5 which included proposal for new paragraphs to be added to the OECD Commentary<sup>17</sup>. After the discussion from the comment received by WP in March 2000, the Committee on Fiscal Affairs released the final version of the changes to the OECD Commentary regarding the concept of PE for ecommerce.<sup>18</sup> In the title of Electronic commerce, ten paragraphs (42.1 – 42.10) were inserted after paragraph 42 of Commentary on Article 5.

In its explanatory notes of the final version, it stated that the Committee reached a consensus on the various issues concerning PE for ecommerce. There were three important points from the consensus. First: a web site cannot, in itself, constitute a permanent establishment. Second: a web site hosting arrangement typically does not result in a permanent establishment for the enterprise that carries on business through that

web site. Third: Internet Service Provider (ISP) will not, except in very unusual circumstances, constitute a dependent agent of another enterprise so as to constitute a permanent establishment of that enterprise.

The problem to define “the place of business” for ecommerce, as mentioned in preceding paragraph, is answered by this change of Commentary for Article 5. It stated that there should be a distinction between a web site and the server on which the web site is stored and used. The enterprise that operates the server may be different from the enterprise that carries on business through the web site. In paragraph 42.3, the server is the place of business for ecommerce. However, the separation is made in the view of by whom the server is operated.

If an enterprise carries on business through a web site and the server operated by another enterprise, it would not constitute a PE. In this case, the web site is considered as intangible that does not have a physical presence. On the other hand, if the same enterprise operates the server and carries on the business through that server, it would constitute a PE.

In April 2004, WP released a draft version for public comments “Proposed Change to The Commentary on Article 5 Concerning Multiple Permanent Establishment”. After receiving several comments, in March 2005 the Committee released the contents of the next update to the OECD Model Tax Convention. The important point from this draft is that when applying the definition of permanent establishment, one must look at a specific enterprise and not at a group of entities as a whole.<sup>19</sup>

The big step of OECD concerning PE in ecommerce is showed in the latest report of OECD<sup>20</sup>. In the last of the Technical Advisory Group (TAG) on Monitoring the Application of Existing Treaty Norms (December 2005), the concept of “virtual PE” was introduced. This concept is categorized as one of the changes that would require a fundamental modification of the existing rules.

There are three alternatives given by OECD to compromise the PE in virtual world. The first is “Virtual Fixed Place of Business PE” which means that PE will be created when the enterprise maintains a web site on a server of another enterprise located in a jurisdiction and carries on business through that web site. This concept has answered the problem of no taxation in previous OECD model for that particular enterprise. Prior to this option, the fact that the enterprise has no physical presence or intangible, give no reason to levy tax. The certainty of PE is cleared when the OECD has decided to assign the web site as the place of business.

If we look deeply to the virtual PE approach, it has the tendency to give more benefit to developed country. It is widely known that the Internet needs an international Internet backbone in order to enhance the capacity of speed and network for ecommerce. International Internet backbone is the big capacity internet

connection functioning as the “main pipe” of international internet traffic. If the server’s location is in the country with international internet backbone, it would give more advantage to get more customers by providing the best speed and service for them. Most of the countries that have the internet backbone are developed country, such as the USA, France, Canada and Australia.

The second option is the Virtual Agency PE. Within this concept, if a web site, by the means of technology, could conclude the contract on behalf of the enterprise then it will be considered to constitute PE. The Virtual Agency PE extend the dependent agent PE concept to electronic equivalent of a dependent agent. The acting of a web site is considered as a dependent agent of that enterprise, regardless the location of the server on which that web site is stored.

The third alternative is “on-site business presence PE”. The economic presence of an enterprise becomes a principle to constitute permanent establishment. Unlike traditional commerce, it does not need the existence of a fixed place of business or business activity taking place within a jurisdiction. As compensation, OECD offers a minimum threshold for source taxation country to ensure taxation will only be applied when a significant level of economic activity has occurred.

From all alternatives, the presence of technology as a legal entity can be regarded as a PE no matter where the place of business is. The concept of economic presence is used to replace the traditional business activity. The concept fixed place of business including the certain degree of permanency is avoided. The conceptual point of “economic presence” is likely similar with the “economic allegiance” concept used in decades ago. One may say that the “economic presence” is the “economic allegiance” in the virtual world.

If the alternatives are accepted, it will be a remarkable point for the development of tax treaty and it will be followed by the huge need to modify the existing rule as a whole. As noted in the report, at least the attribution of profit attributable would make some difficulties under the existing rules. The question is whether the arm’s length principle is capable of application where profits must be attributed by reference to economic activity generated by the interaction between customers of that country and a web site of the enterprise.

Another potential problem comes from the thought of practical and administration point of view. Once the business is considered as PE, it needs to comply with the domestic rule of the jurisdiction country. Tax compliance is one problem and it will be followed by another problem when it comes to auditing the “virtual PE” whose taxpayer does not really “physically” exist.

## 4.2 Studies From Scholars

Before the Internet era, the main focus of tax treaty in the international forum was the principle of source and resident country of taxation. For capital exporting country, the principle of residence was chosen because it was the least to restrict their power to tax income from foreign investment. In contrast, the capital importing country preferred the principle of source that is from where the income was derived should be given the jurisdiction to tax. In the League of Nations tax treaty model, the favor was given upon the principle of residence as the governing principle for tax treaty. It was influenced by UK and the USA as the creditor countries. However, the Mexico and London Model Convention looked more balance and more attractive to capital importing country since the draft was done by a more balanced group of tax administrators and experts from both capital exporting and importing countries. In the UN Model 2001, the model represents a compromise between the source principle and the residence principle, although it gives more weight to the source principle than does the OECD model.<sup>21</sup>

Regarding PE for ecommerce, many studies have been published year by year ever since the recognition of the rapid development of Internet. From those, the work of OECD, as pioneer of the study, has become the standard for the scholars in order to discuss its implication and future development. Furthermore, most of the studies agreed with fundamental principal from OECD as published in Ottawa Taxation Framework. Some studies for PE in ecommerce will be discussed in this sub chapter.

In his paper for Annual Consumer and Commercial Law Workshop at the University of Toronto on October 19, 2002, Arthur J. Cockfield presented his point of view about PE principle through a quantitative economic present test.<sup>22</sup> In his paper, Cockfield suggested that the source country could tax significant cross-border economic activity in a certain quantitative threshold such as gross sale of U.S \$1 million. According to him, this proposal was fit with Mexico Draft from League of Nations which maintained the fixed place of business requirement of PE but also permitted source taxation where significant sales took place within the source country despite an absence of a fixed place of business.

The concept of quantitative economic presence could be regarded as the “half way” of the “virtual PE” suggested by OECD. Instead of using the fully implementation of economic presence of virtual PE, this concept gave a threshold only for significant gross sales by the foreign country.

For the tax compliance problem, a quantitative test might be relatively easy to administer and enforce. A firm without a traditional PE would not have to incur compliance cost and file a tax return in the source state unless the firm surpassed the stipulated threshold. Another advantage is that the principle would only catch

the big firm with significant sales. This concept is supported by the argument that the source country could enjoy the tax revenue from the significant economic activity, encourage a balanced sharing of revenues between residence and source countries as originally envisioned by the PE principle and also the ease of administration.

Other different approach of study for PE in commerce is presented by Nikitas A. Assimakopoulos, George K. Kotsimpos, Anastasios N. Riggas from University of Piraeus, Greece. The idea is how to allocate the profit from a web server which is already considered as PE based on OECD 2001 model. The basic point of this view is that a PE should be treated as a separate profit center that has its own assets, activities and risk. Even if it is not a separate legal entity, PE should be treated as a separate entity.<sup>23</sup>

Considering that a PE should be treated as a separate profit center, the study gave systemic approach in order to allocate the profit of a web server. By using the SAST (Strategic Assumption, Surfacing and Testing) methodology and IP (Interactive Planning) methodology, it can be used to allocate the appropriate profit from a web server. SAST is a dialectical methodology which tries to bring synthesis through conflicts. SAST methodology has four stages: formation of groups, assumption formation, dialectical conversation and composition.

The interesting point from this paper is the establishment of Local Tax Committee (LTC) and International Tax Committee (ITC) for those who follows the OECD model tax convention. The aim of this LTC is to determine the server's own assets and risks. Each country will have one LTC, which will be autonomous from the other LTCs. Each government is responsible for the establishment of each LTC which consists of group of economists, a group of lawyers, a group of computers scientists who specialized in e-commerce issues. The establishment of ITC is to watch over the situation in the area of e-taxation and discussing the new issues that may arise. The directions of LTC will be the main responsibility of ITC. Same as LTC, members of ITC will be a group of economists, a group of lawyers, a group of computers scientists who specialized in e-commerce issues. In addition they should have global knowledge of e-commerce taxation issues.

The application of SAST methodology is used in two levels of LTC, the first is applied inside each LTC and the second is among the LTCs. The key issues inside each LTC are activities, risks, assets developed and assets exploited in the Web Server. Meanwhile the SAST methodology applied among the LTCs is used to transmit each LTC's experience and deal effectively and in a similar and just way with similar problems the

use. The key points for discussion among LTCs are harmful tax competition and similar treatment of cases that have common characteristics.

IP methodology is used in inner operation of ITC. IP is a dialectical methodology, which has five phases: mess formulation, goals designing, designing of means, designing of resources, designing of implementation and control. In each discussion group of ITC, there will be a representative of the other groups as suggested in IP. The goal is to keep an eye on the situation in the area of E-Taxation and discussing the new issues that arise, suggesting new solutions that can be globally applied. This can be achieved by considering what would happen if the International E-Taxation situation stayed as it was, without evolving (Mess formulation phase). Then with the aid of the other phases of IP, actions will be designed for the solution of the emerging new issues and the implementation of the conceived ideas.<sup>24</sup>

When it comes to world tax organization, the previous paper does not stand alone. Frances M. Horner also proposed the establishment of international tax organization.<sup>25</sup> Although the OECD's aim in making some policies in international taxation is not entirely wrong, the paper presents some weaknesses about the main construction, mainly because the nature of the member of OECD itself. Some limitations are that the participants were by invitation only; the agenda for the meeting was set by the OECD countries; and decisions were generally reserved to OECD countries in closed meetings. One example is about allocation of income. Even if a company in an OECD country decided to establish a PE for sales in a developing country, OECD transfer pricing rules for allocating income usually will limit the profit booked in the developing country to a routine profit (a percentage of costs).

Therefore, Horner agreed in the establishment of international / world tax organization. Some conditions should be given in order to put more some balanced perspective, from both developed and developing country and also a protection condition for developing country in taxation matter. Among those conditions are that developed countries should assist developing countries in improving tax administration and developing countries should have a meaningful voice in any world tax body or tax cooperation management.

The most notable proposal for PE in ecommerce is the base erosion approach proposed by Doernberg in 2001.<sup>26</sup> In this principle, the PE will exist whenever a foreign enterprise receives a payment from the source country. Under this rule, the source country would be entitled to impose a withholding tax on all such cross-border payments. The capital importing country has the right to tax all foreign companies within a PE in the jurisdiction. In addition, however, a state of consumption ("state C") would also be given the right to levy a withholding tax on payments with a source in that state to a nonresident vendor (a "state R vendor").

Under this approach, the state R vendor could file a tax return in state C as if the income were attributable to a state C PE in lieu of suffering the withholding tax. Cross-border payments from state C private consumers to state R vendors would not be subjected to withholding because private consumers would not deduct or add the payments to cost of goods sold. The Doernberg paper suggested an across-the-board withholding tax at 10%.

This approach was also written in the latest OECD report in December 2005.<sup>27</sup> The recognition from OECD has opened further serious discussions of this approach. Similar with virtual PE suggestion, the base erosion approach is also categorized as the changes that would require a fundamental modification of the existing rules. Comparing to previous OECD model which was based on the nature of the non resident entity's productive activities in the host jurisdiction, the tax would be due because of a nonresident's business dealings with a customer in the host jurisdiction. However, many OECD members considered that the approach would be more appropriate to justify a consumption tax rather than an income tax.

## **5. What Is Really Necessary for PE in Ecommerce?**

When it comes to PE in ecommerce, several aspects from the nature of ecommerce itself need to be considered. As mentioned in previous chapter, physical existence has become the most critical point. Physical existence is no longer necessary in ecommerce business. Neither office nor building is needed and in many cases even the presence of human or officer is no longer needed. As the compromise between resident and source country for the right of taxation, PE in ecommerce has no need for physical existence. With the absence of traditional PE, we should take a look at the economic activity in which both countries are involved.

In this chapter, some business models from ecommerce will be presented. The aim is to test the latest proposal from tax treaty model against the nature of ecommerce in previous chapter. As discussed before, after the physical existence of ecommerce, the person (seller / buyer) or the company involved and the world wide customers have the tendency to create problem regarding PE in ecommerce.

### **5.1 OECD Approach versus The Nature of Ecommerce**

Let us take a look at the first example of business model of ecommerce with regard to PE principle. Company A in country A has an ecommerce business by selling digital products. To do so, the company put

the web site in their own server in country B. All the operations, assets and risks belong to A Company. A Company has neither office nor physical existence in country B. The customers of A Company are world wide.

Commensurate with the latest report by Technical Advisory Group, it is clear that the A company has a virtual PE in country B. All income attributable to a PE of A Company in country B is subjected to tax in country B. However, another question arises from such case. With the nature of ecommerce business which can have the customer's world wide, there will be no tax for the transaction in other country except country B. The virtual PE alternative only works in country B. Another problem would arise if the A Company only sells the products in particular country except in B country.

If we apply the base erosion approach in this case, the A company has PE in B country and has an obligation to submit a tax return in B country as if the income were attributable to a state B PE in lieu of suffering the withholding tax. The tax return is needed in order to credit the tax from B country for the tax deduction in its own country. The same problem might occur when it comes to the other customers from other country than B. There is no answer in how to deal with the PE from customers' world wide.

For the "on-site business presence PE" approach proposed by TAG of OECD, with a minimum threshold written in both countries, taxation will only be applied when a significant level of economic activity has occurred. Possible threshold might include a minimum time during which the enterprise regularly operates within the jurisdiction or monetary threshold or limitation on the types of activities covered. To some extent, this approach seems to be the most appropriate with some conditions.

This approach could be applied in all transaction of ecommerce whether there is an existence of server or not. The consideration focus on the activities conducted in a jurisdiction rather than on the existence of a fixed place such as server or web site. However, it may facilitate avoidance of a tax liability in the source country by manipulating the specific threshold so that it would not meet any threshold.

Now look at the second example of business model in ecommerce. D company runs the ecommerce business and rent the space from other company which usually called web hosting company. D company does not really know the exact location of the server of that hosting company. All the rental payment for the server is done through online payment. The customers for D Company are also from various countries.

The implementation of virtual PE and base erosion approach to this example has the same problem as the previous example. Due to the cross border transaction that involves many customers around the world, no taxation will occur. This is true especially when the two approaches still consider the PE as the base. In the

borderless world without any clear identification and location, the taxation can only occur by the significant level of economic occurrence.

In those simple examples, it can be seen that the ratification new concept of PE has several limitations. The test shows that the nature of ecommerce business with the world wide customers has made the new PE concept not that easy to implement.

From those approaches introduced by OECD, the compliance cost to implement the approach becomes an issue. The non existence of PE and human intervention of PE in the source country would create difficulties for the taxpayer in residence country. Let say that the A company is considered as virtual PE in country B. It means that A Company needs to register as a registered taxpayer in country A. Furthermore, since there is no branch, office or whatsoever in source country, A Company needs to set up “virtual company” or any other form in order to comply with other tax regulation in country B. This “virtual company” is necessary to calculate the profit attributable to virtual PE.

From all contribution and studies for the taxation in ecommerce, one important point has never been clearly discussed. Though it seems to be a practical and administrative problem, this can be the starting point to solve the problem. The point is how to identify the parties involved in ecommerce. Besides the participants, the exact location of server itself needs to be found. This question should be answered prior the implementation of the solution such as virtual PE, base erosion, etc.

## **5.2 The New Economic Allegiance Concept**

In the new world without border, everyone can conduct business anywhere at anytime. However, the concept of economic allegiance is still capable to approach some problem with ecommerce in taxation especially in PE. This concept is given quantity expression by reference to terms of economic faculty or ability of the individual to pay. According to the four economist in their report to the League of Nations: the point is that when the money has left the pocket of individual, its destination is not a single one but is due to all those government to whom the individual owes economic allegiance. In simple word, to which nations the income tax should be paid is critical.

In virtual world, where the ecommerce business conducted, there is no particular official government involved. The government’s function is only to provide the networking technology to connect to the Internet. This is especially true when we recognized that there is no specific location or identification needed to

connect to the virtual world. In other word, the Internet does not belong to any specific country. Then how is the economic allegiance recognized?

Though it does not belong to any particular country, the individual or the company involved in the transaction is attached to one particular nation or government. The individual must at least reside permanently somewhere in one nation. If we can identify the presence of the individual or the company, it would be easier to acknowledge their PE. Therefore, it needs an “intermediary” institution to identify the concern participants.

This intermediary institution would act as the government in the virtual world. For the taxation matter, it represents the head tax office in virtual world. Like conventional tax office, the virtual head tax office need to register their taxpayer, manage the database of taxpayers’ transaction and distribute the revenue among its branch tax office related to the transaction of their taxpayers. Laws and regulations for the rule of the game are also the responsibility of the intermediary institution.

Once this institution is established, it needs to cooperate with the international Internet organization to negotiate the problem about taxation in ecommerce. For example, if a person want to apply a web site domain in the Internet, it is necessary to give them a single identification number corresponding with their accurate nationality or domicile. This seems to be a small example but in fact it will be a big step for the tax authority. Once the identification is known, it will be easier to define the parties involved.

Like other international organizations, the member of the intermediary institution for taxation should comprise of each country concerned with the Internet taxation. The members must be the combination of knowledge such as tax experts, IT experts, lawyers and economists. The members are also balanced in number between developed and developing countries to deal fairly with the discussion of source and residence principle.

Another benefit of intermediary institution is that the development of taxation on ecommerce will be further enhanced because this institution will do research intensively and continuously. Virtual PE for ecommerce taxation can also be easily to be determined by this institution. For them, determining the virtual PE is like to conclude the traditional PE before the ecommerce occurred.

### **5.3 PE in Ecommerce Era**

The concept of PE is made to avoid double taxation or under taxation. Formerly, it needs basic requirements to constitute PE, such as: physical existence, business activities, human presence and certain period of time. Those requirements appear in the form of office, branch or other business activities in

particular location of foreign country. PE is mostly applied for the multi national company whose has many economic activities world wide. As mentioned in historical background, the idea of PE is some kind of trade-off between source and residence principle for taxing multi national company. By doing so, usually PE is located in source country where multi national company has its branch, office or place of management to do business in foreign country. The profit acquired through PE is usually limited to specific area within the boundary of source country.

How about PE in ecommerce? With the nature of ecommerce, some basics requirements are no longer necessary. It will be difficult to define the former concept of PE when there is no physical existence and human presence. The source country or the location of business income acquired might be different with the location of the center of business activities. If a company creates a web site and uses its own server in domestic country and sell occasionally or permanently in foreign country, it will not fit with the concept of PE in former day. Server or web site can be placed anywhere and can be either the same or different place with customers' location or source country. It can be seen that the location of server or web site can not be the justification to constitute PE. The latest concept of PE in OECD model only can be applied if the location of the server or web site is similar with the market place of ecommerce. Hence, the PE is only constituted for that particular country; meanwhile other countries whose customers are also purchasing products can not identify their PE.

PE in the early stage is formed by the concept of economic allegiance from which the economic activities is identified. On the other hand, the economic allegiance of PE in ecommerce era is diluted by the disappearance of physical existence. Economic activities is no longer can be identified by the existence of office or such kind of place of management. This is especially true when the customers are world wide and the goods or services sold are digital. But the economic activities are still there. The residence and source country are also still there. Therefore, it needs a new bench mark to avoid double taxation and to allocate appropriate tax revenue in ecommerce era.

Back to the principal of PE which is doing business in certain boundary area, the same idea can be applied to ecommerce transaction. It means that if company sells its products, partly or wholly from the Internet, in specific country within the certain numbers of transactions or customers, regardless the location of server or web site and the physical existence, it will constitute PE in that country. When a company sells their products in specific country for several times, it means that this company has already studied the customers' behavior in that country and ready to compete with other companies to obtain profit. The products sold are also

customized with the needs of the customers in that country. It applies the concept of economic allegiance. There is also a possibility to sell the products to other countries with the same economic and geographical background with that country. Thus, it will also constitute PE in that other country.

Why the amount of transaction is chosen instead of the amount of money being transferred? There are two reasons. First, in the basic principle of PE, only if there is business activities will constitute PE. The business activities are considered by the transactions or deals in boundary area regardless the amount of money involved. The second reason is that when the company ready to sell their products in specific area, it readies to sacrifice their assets and risks in order to obtain profit. Market orientation, geographical and economic conditions have become the justification to choose the customers. Meanwhile, the amount of money being transferred can be happened coincidentally without any risks. This concept can be called as “*permanent transaction*” in which the rationale is based on the numbers of transactions and economic risks. In other word, with or without office the final transaction is aimed to that specific country.

To identify the number of transactions, it can be done by the intermediary institution mentioned before. Of course, it needs help from the third party especially from the international organization for ecommerce or international financial institution. Meanwhile the number of transactions is subject to negotiation between the contracting states.

## **6. Conclusion**

The formal basic concept of permanent establishment was found in the early tax treaty model of League of nation in 1928. After prevailing for many years, the PE principal has to change in order to keep up with the development of information technology. In Internet era, studies and examinations have been done by scholars and international organizations such as UN and OECD.

The dilution from the principle of PE caused by ecommerce has made the notable change in the concept of PE. The physical existence, fixed place of business and human intervention are the most common issue when discussing about PE in ecommerce. Due to the nature of ecommerce, some conventional philosophy of PE could not fit with the emerging development of ecommerce. As a result, changes are needed for PE. However, from many approaches for PE in commerce, the most critical point is not being touched. The identity of the party involved which can be followed by the location of the server has never been really discussed.

In the world without border, the concept of economic allegiance still has some meanings. The philosophy of that concept which was introduced by the four economists many years ago is still applicable to deal with the problem of PE in ecommerce. When it comes to ecommerce transactions, the individual's ability to pay is not attached only to a single government but is due to all those government to whom the individual owes economic allegiance.

Nevertheless, in practice, it is not easy to determine which government should receive the revenue from such kind of business. Especially since the Internet does not belong to any particular government. When the Internet linked the people world wide, one might say that either many governments or none government have the right to declare their jurisdiction. Therefore, it needs one official intermediary institution in order to manage the taxation matter in ecommerce. This organization could then act as the central figure to determine the virtual PE and distribute the appropriate apportion of revenue to each country.

The international intermediary organization proposed becomes the first footstep to cope with the problem of ecommerce in international taxation matters. Of course, some conditions are needed in order to give framework for the organization to work adequately in giving the same beneficiary for developed and developing countries.

Economic allegiance principle can also be used to determine PE in ecommerce. By looking at economic activities in number of transactions, "*permanent transaction*" can be regarded as PE regardless the location of the server or web site and the physical existence. Even though look different with the formal PE; the basic principal of PE is still applied. This approach is quite similar with "on-site business presence PE" approach by OECD. However, for the point that can constitute PE, the number of transactions is chosen instead of the monetary threshold or minimum time of regular operation from the company.

It is not easy to give the comprehensive solution to deal with PE in ecommerce. It needs a lot of studies and researches especially with the complexity of the business model from ecommerce. One solution may not match with other specific condition from other business model of ecommerce. Therefore, it needs continues and intensive study to get the latest information. And also it needs to consider the future development of ecommerce.

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