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Tax Challenges of the Digital Economy: Does a Withholding Tax on Certain Digital Transactions Solve the Problem of Missing Taxation Rights, While Being In Line with EU-Law and the OECD Model Convention?

by

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Table of Abbreviation

Abbreviation	**Explanation**
Art.	Article
B2B	Business to Business Transaction
B2C	Business to Consumer Transaction
BEPS	Base Erosion Profit Shifting
BEPS Project	The Final Report of the Base Erosion Profit Shifting Project of the OECD 2015
C2C	Consumer to Consumer Transaction
CIT	Corporate Income Tax
C.f.	Latin: *conferatur* Used to indicate an indirect quote. It referes to the general idea of another written statement
The Commission	Commission of the European Union
DST	Digital Service Tax
DTT(s)	Double Taxation Treaty(s)
EU	The European Union
EU-Law	European Union Law (including all sources of law on the level of the EU)
Ibid.	Latin: *ibidem* Used to reference to a quoted work which has been already mentioned in previous references
IFA	International Fiscal Association
Market State	State of Economical Activity (State in which domestic market the actual provision of the digital advertisement service takes place)

No.	Number
OECD	Organization for Economy Co-Operation and Development
OECD MC	OECD Model Convention and Commentary with respect to Taxes on Income and on Capital condensed Version of 2017
p.	Page
para.	Paragraph
PE(s)	Permanent Establishment(s)
PMNE(s)	Product-Multinational-Enterprise(s) (Multinational active Product Enterprises and contractual partner of the Social-Media-Multinational-Enterprise)
Resident State	State of Residency (State where the Social-Media-Multinational-Enterprise is registered for tax purposes)
SMNE(s)	Social-Media-Multinational-Enterprise(s) (Multinational active Social-Media-Business-Models like Facebook)
Source State	State of the Source of Income (State where the source of the income of the Social-Media-Multinational-Enterprise is located)
TEU	Treaty on the European Union
TFEU	Treaty on the Function of the European Union
VAT	Value-Added-Tax
Vol.	Volume
WHT	Withholding Tax

Abstract

This thesis investigates whether the implementation of a withholding tax on financial transactions obtained by the provision of certain digital services could solve the current problem of missing taxation rights regarding the income of highly digitalized multinational business models.

Furthermore, the thesis aims to determine whether such tax could be in line with European Union law and the model convention for double taxation treaties issued by the OECD.

1 Introduction

1.1 Topic

The Digitalization facilitates the possibility for multinational enterprises to establish business models in various jurisdictions with minor or no physical presence in the state where the actual business activity takes place (hereinafter: the Market State).[1] The thesis focuses on the issue of missing taxation rights of the Market State, where a certain digital service is provided without any physical presence of the multinational active and highly digitalized service provider.

This investigation explains whether the implementation of a withholding tax (WHT) on the income of such business model generated from the territory of the Market State could solve the issue of missing taxation rights for such state. Furthermore, the investigation determines whether such tax would be in line with European Union law (EU-Law) and Double Taxation Treaties (DTTs) drafted in accordance with the 2017 Model Convention issued by the Organization for Economy Co-Operation and Development (OECD).

1.2 Characteristics of the Digital economy

Digitalization is considered the most important development of the global economy during the 21st century.[2] As well as one of the major drivers of investments, job creation and sustainable growth within the international market.[3] The digital economy does not only allow multinational enterprises to establish new highly digitalized business models,[4] but also traditional business models become more digitalized.[5] Thus, the digital economy is impacting all sectors of the global economy and modern society.[6] Ring-fencing the digital economy for tax purposes from the rest of the economy is therefore impossible and inappropriate.[7]

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[1] Study of the European Parliament-Think Tank requested by the TAX3 Committee, "The Impact of Digitalisation on International Tax Matters- Challenges and Remedies" (15.02.2019), p.10.

[2] Report of the Commission Expert Group on Taxation of the Digital economy, European Commission (May 2014), p. 5, Executive Summary.

[3] OECD, "Tax Challenges Arising from Digitalization – Interim Report 2018", p. 12. Chapter 1.1., no.1; M. Olbert/C.Spengel, „International Taxation in the Digital economy: Challenge Accepted?", World Tax Journal 2017 (Vol.9 No.1), p. 4.

[4] Report of the Commission Expert Group on Taxation of the Digital economy, European Commission (May 2014), p. 21-22, Chapter 2.2.

[5] On the issue of the digitalization of traditional businesses: S. Prasanna, "Digitalization of Traditional Business Models: Transfer Pricing Implications of Business Restructurings", International Transfer Pricing Journal 2018 Vol. 25 (No.6).

[6] OECD, "Digital economy Outlook 2015", p.11; B. Westberg, "Taxation of the Digital economy- An EU Perspective", European Taxation 2014 Vol. 54 (No.12), p. 541.

[7] OECD, "Addressing the Tax Challenges of the Digital economy", BEPS Project 2015, Action 1: Final Report, p. 11 and p. 54 no.115; W.Schön, "Ten Questions about Why and How to tax the Digital economy", Bulletin for International Taxation 2018 Vol. 72 (No.4/5), p. 280-281, Chapter 2.

Nevertheless, the digital business models present key characteristics which are increasingly relevant from a tax perspective.[8] They posses a high level of mobility, reliance on intangibles, data and network effects, a tendency towards monopoly or oligopoly and volatility.[9] The highly digitalized business models contain several varieties of e-commerce, app-stores, online advertisement, cloud services, networks platforms, high speed trading and online payment services.[10] These emerging digital business models give access to new markets as well as new opportunities for innovation and employment.[11] However, what makes the ongoing digitalization a major accelerator of cross-border trade[12] and a facilitator of worldwide incorporated value-chains[13] also exacerbates broader international tax challenges.

1.3 Tax Challenges of the Digital economy

The digitalization enables multinational enterprises to establish highly digitalized business models in various jurisdictions with minor or non-existent physical presence in the Market State.[14] These multinational active and highly digitalized business models are shifting profits to low-tax-jurisdictions in order to artificially reduce their tax burden by exploiting loopholes in the interaction of different domestic tax systems.[15] These loopholes are especially created by the key characteristics of the digital business models. These new characteristics are undermining the current international tax system by decreasing the relevance of the concept of physical presence, increasing the importance of intangible assets and introducing value creation due to data usage, leading to value-creation-chains within several jurisdictions. These circumstances raise the fundamental questions of how to define and characterize the terms of income, value creation and permanent establishment (PE) within the digital economy.[16] The business model of social-media-platforms such as *Facebook*, *Instagram* or *Twitter* are especially challenging for the international tax regime. Such multinational active Social-Media-Enterprise (SMNE) is an online platform providing free access to a network in

[8] Ibid. No. 2 at p. 11-13, Chapter 1.1.
[9] Study of the European Parliament-Think Tank requested by the TAX3 Committee, "The Impact of Digitalisation on International Tax Matters- Challenges and Remedies" (15.02.2019), p.10.
[10] OECD, "Addressing the Tax Challenges of the Digital Economy", BEPS Project 2015, Action 1: Final Report, p. 11.
[11] Ibid. No.10.
[12] The European Commission, "Communication from the Commission to the European Parliament and the Council – A Fair and efficient tax system in the European Union for the Digital Single Market" (21.09.2017), COM (2017) 547 final, p.3.
[13] Ibid. No.10.
[14] Ibid. No.1.
[15] Ibid. No.10 and at Executive Summary p. 16.
[16] Ibid. No.10 at p. 16 no.2 and p.99; OECD, "Tax Challenges Arising from Digitalization – Interim Report 2018", p.18, no.17; M. Olbert/C.Spengel, „International Taxation in the Digital economy: Challenge Accepted?", World Tax Journal 2017 (Vol.9 No. 1), p. 5.

exchange for personal data, which are used to deliver personalized advertisement to users.[17] Out of the new digital business models the SMNE and its supply of personalised advertisement is especially difficult to fit into the current international tax scheme, given the whole process can be completely digital.[18]

1.4 The OECD and European Approach

Even though the OECD published a statement concerning the tax challenges of the digital economy[19] already in 2015,[20] there is still no meaningful adjustment of the PE-concept regarding the OECD Model Convention (OECD MC) in this particular subject[21]. Any other multinational solution or recommendation how to tax the digital economy issued by the OECD is also still missing. The European Union (EU) tried as well to tackle the tax challenges of the digital business models and published two proposals for directives regarding the taxation of the digital economy.[22] The proposals include a long-term solution in the form of implementing a new virtual PE-nexus and rules to allocate profits of digital business models relying on intangibles.[23] As well as a short-term solution in form of a special Digital Service Tax (DST).[24] Despite this, the 28 Member States of the EU were not able to settle on a coherent DST-scheme[25] or implement a virtual PE-nexus. Nevertheless, neither the OECD nor the Commission explicitly recommend a domestic measure to tax the digital economy.[26]

Given the many conflicting interests involved on a multinational scale and thus the divergence of the opinions among states how and to what extent the current tax system and PE-nexus should be changed, it seems to be unlikely that an international consensus will be reached in the near future.[27] Based on the international sense of political precedence surrounding the issue of

[17] Ibid. No. 12 at p. 5; Ibid. No. 10 at p. 54-64, Chapter 4.2; Ibid. No.1 at p. 21, Chapter 2.2.
[18] Analysis of the implementation of a WHT-System regarding other digital business models see: Y.Brauner/A. Baez, "Withholding Taxes in the Service of BEPS Action 1: Adress the Tax Challenges of the Digital Economy, IBFD-Workingpaper, 02.02.2015, Appendix. Case Study, p.27-32.
[19] The OECD identified as the main problems the current tax nexus, the use of data by digital MNEs concerning value attribution and the characterization of payments made for digital products and aims that such business profits must be taxed in line with the place of value creation and economic activity: Ibid. No.10 at p.101-102,104, 105, 136.
[20] Ibid. No. 10.
[21] OECD: "Model Tax Convention on Income and on Capital: Condensed Version 2017" (November 2017).
[22] European Commission, COM (2018) 147 Final-2018/0072 (CNS) and European Commission, COM (2018) 148 Final-2018/0073 (CNS).
[23] European Commission, COM (2018) 147 Final-2018/0072 (CNS) p. 2 and p. 12.
[24] European Commission, COM (2018) 148 Final-2018/0073 (CNS).
[25] U. Lomas, „Still No Deal On EU Digital Service Tax", Wolters-Kluwer, Global Tax News, Article, p. 1.
[26] Ibid. No. 10; Ibid. No.21.
[27] A. Bal, "(Mis)guided by the Value Creation Principle- Can new concepts solve old problems?", Bulletin for International Taxation 2018 Vol. 72 (No.11), p.6.

enforcing taxation regarding the digital economy[28] and the amount of untaxed business profits of digital businesses,[29] various states want to pursue the implementation of a national tax on certain digital revenues in the domestic legislation.[30]

1.5 Aim

The purpose of this thesis is to determine whether the implementation of a WHT would solve the current problem of missing taxation rights for the Market State. Therefore this thesis explains how the implementation of such WHT on income generated by a non-resident SMNE within the jurisdiction of the Market State could solve the current problem of missing taxation rights for that state. Furthermore, the thesis aims to analyses whether such WHT would also be in line with EU-Law, and DTTs drafted after the OECD MC.

1.6 Delimitation

The issue of a new virtual PE-nexus,[31] the term of value creation through data usage[32] or the application of transfer pricing rules and methods[33] within the digital economy are well covered in the current international literature. These topics will therefore not be discussed in this thesis. Moreover, the change of the PE-concept and adjustment of transfer pricing rules to determine value creation within the digital economy need a multinational consensus.[34] In this sense, a WHT can be realized on a multinational scale,

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[28]Ibid No. 10 at p.1; Ibid. No. 22 at p.16, no.6; European Commission, „Impact Assessment“, (21.03.2018), SWD (2018) 81 final/2, p.6.

[29] European Commission, “Fair Taxation for the Digital economy – Fact Sheet” (March 2018), p.4.

[30] European Commission, „Impact Assessment“, (21.03.2018), SWD (2018) 81 final/2, p. 54.

[31] About the issue regarding the new PE-nexus: D.Blum, “Permanent Establishments and Action 1 on the Digital economy of the OECD Base Erosion and Profit Shifting Initiative- The Nexus Criterion Redefined?”, Bulletin for International Taxation 2015 Vol. 68 (No.6/7); Y. Brauner/P. Pistone, “Adapting Current International Taxation to New Business Models: Two Proposals for the European Union”, Bulletin for International Taxation 2017 Vol. 71 (No.12); L. Sheppard, “Digital Permanent Establishment and Digital Equalization Taxes”, Bulletin for International Taxation 2018 Vol. 72 (No.4a; Special Issue); Y. Brauner/P. Pistone, “Some Comments on the Attribution of Profits to the Digital Permanent Establishment”, Bulletin for International Taxation 2018 Volume 72 (No.4a; Special Issue).

[32] About the issue regarding (User) Data and value creation: A. Dourado, „Digital Taxation Opens the Pandora Box: The OECD Interim Report and the European Commission Proposals”, INTERATX 2018 Vol. 46 (Issue 6&7); S. De Jong/W.Neuvel/A.Uceda, “Dealing with Data in a Digital economy”, Bulletin for International Taxation 2018 Vol. 72 (No.11); M. Olbert/C.Spengel, „International Taxation in the Digital economy: Challenge Accepted?”, World Tax Journal 2017 (Vol.9 No.1), p. 9-10; P.Valente, “The Data Economy: On Evaluation and Taxation”, European Taxation 2019 (Vol.59 No.5)Chapter 3 and 4, p. 253-255.

[33] About the issue regarding the transfer pricing methods and rules within the digital economy: R. Petruzzi/S.Buriak, “Addressing the Tax Challenges of the Digitalization of the Economy- A Possible Answer I the Proper Application of the Transfer Pricing Rules?”, Bulletin for International Taxation 2018 Vol. 72 (Special Issue No.4a); A. Samari, “Digital economy and Profit Split Allocation: The Application of the Profit Split Method to the Value Created by a Significant Digital Presence”, International Transfer Pricing Journal 2018 Volume 26 (No.1); S. De Jong/W.Neuvel/A.Uceda, “Profit Attribution Challenges in a Digital economy- A Transfer Pricing Analysis of the EU Virtual Permanent Establishment Concept”, Bulletin for International Taxation 2018 Vol. 25 (No.5).

[34] Ibid. No. 10; M. Olbert/C.Spengel, „International Taxation in the Digital economy: Challenge Accepted?”, World Tax Journal 2017 (Vol.9 No. 1), p. 13-15.

as well as on a domestic level. Thus, a WHT could be implemented without a multinational consensus. The proposed European DST is used in subchapter 5.4.1 as an example to illustrate the issue how specific characteristics of a tax can influence the overall legal nature of such specific tax on certain digital transactions. However, it must be emphasised, that the DST would be collected in the state, where the consumer of the digital service in question is located.[35] This tax therefore follows the principle of destination taxation and is not a source tax collected by a WHT-mechanism.[36] Consequently, the DST is generally out of scope of this thesis. The relevant articles for the following analyses are the articles 7, 10 and 11 of OECD MC. These articles do not significantly differ to the articles 7, 10 and 11 of the Model Double Taxation Convention issued by the the Untied Nations[37]. Hence, a dedicated analysis of the Model Double Taxation Convention of the Untied Nations is not necessary. Moreover, would the introduced WHT for services in the Model Double Taxation Convention of the Untied Nations require an analysis whether the services provision of the SMNE would be connected or similar to a service provision by a PE. Such analysis is also out of scope of this thesis.

1.7 Method and Materials

In order to provide an answer to the legal question of this thesis the traditional legal dogmatic method[38] is used. The core features of this method are the following[39]:

(i) Arguments are derived from authoritative sources, such as exciting rules principles and scholarly publications;
(ii) The law is presented as a coherent net of principles and rules as different levels of abstractions;
(iii) The decision of individual cases has to fit into the current system to avoid arbitrary results.

The thesis is guided by authoritative sources such as the BEPS Project,[40] the OECD-Outlooks,[41] the OECD-MC-Commentary[42] and OECD-Reports[43] and the published legal opinions about the tax challenges of the digital economy

[35] Art.5 of the DST-Directive, European Commission, COM (2018) 148 Final-2018/0073 (CNS), p.27.
[36] Ibid. No. 2 at p.5.
[37] See Art. 7,10,10 of the Model Convention of the United Nations; United Nations: „Model Double Taxation Convention between Develpoed and Developing Countries“, 2017. p.15-16; p.19-22 .
[38] S. Douma, “Legal research in International and EU Tax Law”, Kluwer, December 2014, p.18.
[39] R. van Gestel/H.Micklitz, „Revitalising Doctrinal Legal Research in Europe: What About Methodology?“ EUI Working Paper, LAW 2011/05, p.26.
[40] OECD, “Addressing the Tax Challenges of the Digital economy”, BEPS Project 2015, Action 1: Final Report.
[41] OECD: “Digital economy Outlook 2015”.
[42] OECD: “Model Tax Convention on Income and on Capital: Condensed Version 2017 and Commentary” (November 2017).
[43] OECD, “Tax Challenges Arising from Digitalization – Interim Report 2018”.

issued by the different bodies of the EU.[44] Furthermore, published academic papers, textbooks and commentaries are consulted as well as analysed to give a sustainable opinion of the legal question of this thesis.[45] The applied coherent net of principles and rules is therefore the legislation and jurisprudence of the EU and the guidelines and general principals of the OECD MC. To achieve the aim of the thesis, first an analysis of the general concept of WHT and how such tax could be applied on the SMNE is required. Secondly, an analysis whether such tax also would be inline with EU-Law and the OECD MC will follow, focusing whether such tax would infringe Art. 401 of the VAT Directive[46] or European Fundamental Freedoms and whether that kind of WHT would fall within the scope of the Art. 2 OECD MC. The analysis of the general characteristics of a WHT-scheme in a domestic and international context is based on the IFA Report of 2018[47] based on the fact, that most academic writing surrounding this topic does not evaluate the WHT-System in general, only specific (domestic) issues. This comprehensive report is issued by a group of respected tax experts and scholars including the analysis of the WHT-system of 38 states. This report is therefore a reliable source to illustrate an overview of the domestic and international use of the WHT-mechanism of Member States of the EU and the OECD. This thesis is exclusively based on the materials published until the 6th of June 2019. Later publications, if any, have not been examined.

1.8 Outline

The analysis will be structured in 6 chapters. The next chapter describes the general concept of WHT in a domestic and international content. The third chapter discusses the application of such WHT on the SMNE and whether this implementation solves the current problem of missing taxation rights for the Market State. This chapter also includes a brief economical analysis whether the economical incidence of this WHT would be actually carried by the digital SMNE in question. The fourth chapter analysis whether the WHT infringes fundamental freedoms of the TFEU or other EU-law-principles. The fifth chapter analysis whether this tax would be covered by the OECD MC or would lead to international double taxation problems. The last chapter concludes the findings of the thesis.

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[44] The European Commission, "Communication from the Commission to the European Parliament and the Council – A Fair and efficient tax system in the European Union for the Digital Single Market" (21.09.2017), COM (2017) 547 final; Study of the European Parliament-Think Tank requested by the TAX3 Committee, "The Impact of Digitalisation on International Tax Matters-Challenges and Remedies" (15.02.2019); Report of the Commission Expert Group on Taxation of the Digital economy, European Commission (May 2014); European Commission, „Impact Assessment" (21.03.2018), SWD (2018) 81 final/2.

[45] See Bibliographie.

[46] Article 401 of the Council Directive 2006/112/EC of 28.11.2006 (OJ L 347; 11.12.2006) as amended.

[47] IFA Cahiers: "Report 2018 on Withholding Tax in the Era of BEPS, CIVs and Digital economy", General Report (Vol. 103B).

2 Concept of Withholding Taxes

Within a WHT-system the tax is collected at the source of the income within the jurisdiction where the income is generated.[48] In most jurisdictions the WHT-system is not universally applied for all types of income.[49]

2.1 Domestic Context

In a domestic setting, the WHT mostly serves as an advance payment of tax and an additional tax payment or a refund follows.[50] Generally, the WHT-system is in the domestic context technically a collection system: the payer of the income in question ("withholding agent") withholds a certain portion of the amount paid to the income recipient and transfers it, to the domestic tax authorities for the account of the income recipient.[51] Regardless, the WHT can be the only applicable tax on particular types of income as a final tax where the comprehensive domestic income tax system cannot readily apply.[52] Here, it is important to note that passive income from capital, investments, interests, dividends or royalties are often subject to WHTs,[53] whereas business income is mostly not subject to WHTs.[54]

2.2 International Context

Within the international context, the WHT-System also establishes limits of enforceable taxation rights between the state where the entity in question is registered for tax purposes (hereinafter: the Resident State) and the state from which territory the income is generated (hereinafter: the Source State).[55] In an international setting, WHTs apply almost universally to passive income including interests, dividends and royalties as well as to certain business profits, unless they are attributed to PEs within the territory of the Source State.[56] Depending on the jurisdiction of the Source State, a presumptive or standard deduction of a certain percentage of the income is automatically deducted from the WHT-tax base, to attempt the approximate net income.[57] As already mentioned, a WHT is only applied as a final tax where the comprehensive domestic income tax system cannot readily apply. Based on the fact, that non-resident recipients of income are usually not required to file an income tax return in the Source State, this state is not in a suitable position to identify the net income from a particular isolated transaction. Therefore the WHT is -in an international context- often a final

[48] C.Lee,/J. Yoon, "IFA Cahiers Report 2018 on Withholding Tax in the Era of BEPS, CIVs and Digital economy", General Report (Vol. 103B), p.7, Introduction: Background.
[49] Ibid. No.48 and Introduction: Background also p. 11, Chapter I.1.1.
[50] L.Burns/R.Krever in „Tax Law Design and Drafting", V. Thuronyi ed. 1998, Vol. 2, Chapter 16, Subchapter B, p.70.
[51] Ibid. No.48 at p.7.
[52] Ibid. No.48 at p.13, Chapter I.1.2.
[53] Ibid. No.50 at p.70-71; Ibid. No.48 at p.12, Chapter I.1.1.
[54] Ibid. No. 49.
[55] Ibid. No.48 at p.18, Chapter II.1.
[56] Ibid. No.50 at p.70-71; Ibid. No.55.
[57] Ibid. No.48 at p.21, Chapter II.2.6.

tax.[58] Consequently, the WHT-System is mostly used in an international context by states to ensure the enforcement of their taxation rights in case that the common domestic income system is not applicable.

2.3 Interim Conclusion

As shown is the WHT-system in general capable of ensuring and enforcing taxation rights of the Source State within an international context. Especially in the scenario when the comprehensive domestic income tax system cannot readily apply, such as cross-border transactions with non-resident parties or the involvement of passive income from intangible assets. This mechanism seems to be fitting to solve the tax problems arising from the digital economy.

3 The Withholding Tax Scheme applied to Digital Businesses

This chapter analyses whether a WHT-scheme actually solves the current problem of missing taxation rights for the Market State on the example of the SMNE.

3.1 Characteristics of the Social-Media-Model

SMNEs like "Facebook", "Instagram" or "Twitter" are multisided online platforms providing free access to a social network.[59] This business model covers two business streams: the business to consumer (B2C) side and the business to business (B2B) side.[60] Typical for the SMNE is that these two business streams are directly linked.[61] For the worldwide located network users (B2C transaction) the SMNE (by itself or through local subsidiaries) provides free access to the online platform and user support.[62] In exchange for this service provision the SMNE collects, processes and stores the generated user data.[63] These user data are voluntarily provided by the network users in the form of demographic and geographic information, content uploads, behavioural data and user-to-user-interaction.[64] To keep the online platform running for the users, mostly intangible assets like software, algorithms and application programs are used.[65] The only physical assets

[58] Ibid. No.50.
[59] The European Commission, "Communication from the Commission to the European Parliament and the Council – A Fair and efficient tax system in the European Union for the Digital Single Market" (21.09.2017), COM (2017) 547 final, p. 5; OECD, "Addressing the Tax Challenges of the Digital economy", BEPS Project 2015, Action 1: Final Report, p. 58, Chapter 4.2.4 and p. 62, Chapter 4.2.7; Report of the Commission Expert Group on Taxation of the Digital economy, European Commission (May 2014), p. 21, Chapter 2.2.
[60] OECD, "Tax Challenges Arising from Digitalization – Interim Report 2018", Chapter 2.4.1, p. 45, no. 106.
[61] Ibid. No.60 .
[62] Ibid. No.59.
[63] OECD, "Tax Challenges Arising from Digitalization – Interim Report 2018", Chapter 2.4.1, Schematic on p. 47, Panel B; "Primary Activity".
[64] Ibid. No. 60 at no.105.
[65] Ibid. No. 63 at Panel B, "Technology".

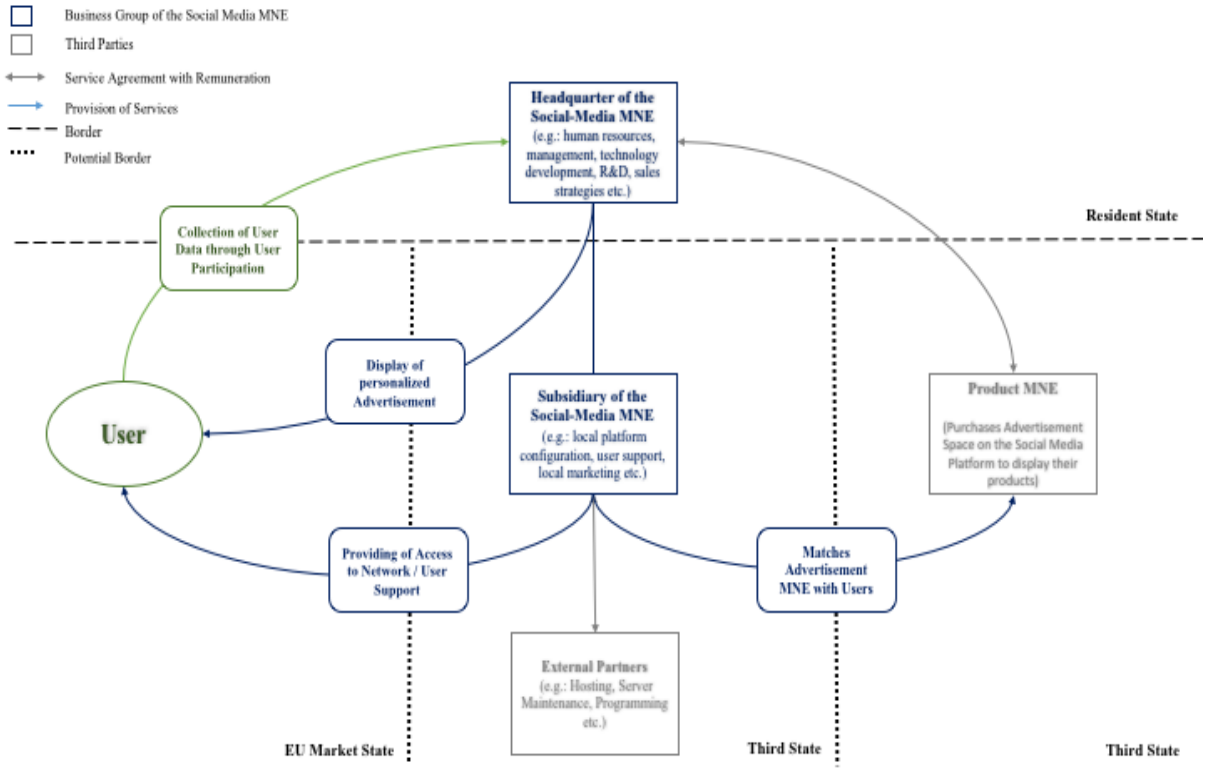
needed are the computer hardware and servers, as well as the human resources behind the technology. These assets can be located anywhere due to the usage of information and communication technology.[66]

In context with globally located businesses (B2B transaction), the SMNE is concluding agreements to display personalized advertisements on the purchased advertisement spaces in exchange for a remuneration.[67] The products are displayed on the news feed of the user fitting the determined target audience, selected by the collected and monetized user data.[68] For this business activity, also mostly intangible assets like monetizing software and various algorithms are used.[69] The only physical assets needed are the computer hardware and servers to store and process the user data.[70]

The SMNE generates the majority of its revenue from the received payment generated by the described digital advertisement services provided for the contractual partners (the multinational active product enterprises; hereafter: PMNE).[71] Between the users and the platform (B2C) and the users themselves (C2C) no financial transaction takes place.[72]

The following figure[73] briefly summarizes the illustrated features of the SMNE which are important for the following discussion of the emerging tax issues:

[66] Ibid. No.63.
[67] OECD, "Addressing the Tax Challenges of the Digital economy", BEPS Project 2015, Action 1: Final Report, p. 58, Chapter 4.2.4.
[68] Ibid. No.64.
[69] Ibid. No.65.
[70] Ibid. No.65.
[71] Ibid. No.60 at no. 107.
[72] OECD, "Tax Challenges Arising from Digitalization – Interim Report 2018", Chapter 2.4.1, Schematic on p. 45.
[73] Adaption and simplification of the figure of the OECD by the author: OECD, "Tax Challenges Arising from Digitalization – Interim Report 2018", Chapter 2.4.1, Schematic on p. 45.



3.2 Tax Challenges of the Social-Media-Model

Based on the business structure, the headquarter of a SMNE can be located anywhere in the world and is thus not tied to a specific geographical location.[74] Also the subsidiaries of such SMNE are highly flexible regarding their geographical location. For instance, the subsidiary responsible to cover the European Market can be located in a small Member State with a beneficial corporate income tax (CIT) jurisdiction, while collecting data from users located in another Member State with a large market. Due to its characteristics the SMNE is the epitome of the new evolving digital business models: it includes a high level of mobility and relies nearly exclusively on intangible assets[75] such as intellectual property rights,[76] the collected user data[77] and the size of members and user interaction of the Social-Network itself.[78] This business model leads to a pure digital business activity with a value creation chain[79] spread over various jurisdictions.[80] As shown, the SMNE is able to collect user data and provide digital advertisement services in various jurisdictions without any or just minor

[74] Ibid. No.60 at no. 107.
[75] Ibid. No.60 at p. 52, no.135.
[76] Ibid. No.60 at p. 56, no.108.
[77] Ibid. No.76 at no.109
[78] Ibid. No.76 at no.110.
[79] A. Dourado, „Digital Taxation Opens the Pandora Box: The OECD Interim Report and the European Commission Proposals", INTERATX 2018 Vol. 46 (Issue 6&7); S. De Jong/W.Neuvel/A.Uceda, "Dealing with Data in a Digital economy", Bulletin for International Taxation 2018 Vol. 72 (No.11); M. Olbert/C.Spengel, „International Taxation in the Digital economy: Challenge Accepted?", World Tax Journal 2017 (Vol.9 No.1), p. 9-10.
[80] OECD, "Addressing the Tax Challenges of the Digital economy", BEPS Project 2015, Action 1: Final Report, p. 11.

physical presence in the territory of the Market State. In this regard, the SMNE is registered for tax purposes in the Resident State and only files a tax return and pays taxes in this jurisdiction. These circumstances lead to economical presence in the Market State without any physical presence of the SMNE in this jurisdiction. Due to the current treaty rules, which are still connecting taxing rights in cross-boarder situations to the legal concept of a physical presence (e.g.: a PE), the lack of actual physical presence of the SMNE leaves the Market State with no taxing rights over the business income of the SMNE.[81]

In contrast comparable traditional business models like television agencies broadcasting programs and commercial advertisements[82] and traditional marketing agencies are geographically bounded to the Market State. Based on television network hardware, infrastructure like servers, studios, television devices, human resources or domestic market research and local advertisement contractors.[83] These comparable traditional business models are therefore economically as well as physically present in the Market State and also creating value in this jurisdiction. According to current treaty rules the place of value creation, economical activity and tax residency are within the jurisdiction of the Market State. These circumstances are leading to taxation rights for the Market State over the income of these business models.

3.3 Implementation of the Withholding Tax Scheme

This section will analyse whether the implementation of a WHT-system could establish a taxation right for the Market State regarding the income of the SMNE sourced with the territory of this Market State.

3.3.1 Tax Purpose

The main purpose of implementing a WHT on certain digital services would be to protect the domestic tax systems and national tax basis by closing current legal gaps which are leading to tax base erosion, aggressive tax planning and profit shifting by multinational enterprises.[84] From an European point of view, the implementation of a special tax on digital transactions is caused by the aim to protect the integrity of the European Single Market,[85] to ensure the public finance system, to persevere a fair

[81] OECD, "Addressing the Tax Challenges of the Digital economy", BEPS Project 2015, Action 1: Final Report, p. 11, Executive Summary and p. 16.; OECD, "Tax Challenges Arising from Digitalization – Interim Report 2018", Chapter 2.5.1, p. 51, no.132.
[82] OECD, "Tax Challenges Arising from Digitalization – Interim Report 2018", Chapter 2.4.1, p. 46, no.110.
[83] Ibid. No.82 at Schematic on p. 47, Panel A.
[84] C.Lee,/J. Yoon, "IFA Cahiers Report 2018 on Withholding Tax in the Era of BEPS, CIVs and Digital economy", General Report (Vol. 103B), p.18, Chapter II.1.
[85] Art. 3 para. 3 TEU, Art. 4 para. 2 no.a TFEU, Art. 26 TFEU, ensured by the following provisions: Art. 18, 21, 28-33, 34-36, 45, 49, 56-58, 63 TFEU.

competition for businesses and to guarantee a fair allocation of the social burden of taxes.[86] In general, the aim of such WHT on certain digital transactions is to establish a taxation right for the Market State in order to preserve the national tax basis.

3.3.2 Tax Object

The basic principle of international income taxation stipulates, that profits should be taxed where the value is created.[87] As shown, the exact place and jurisdiction, where the value creation takes places is difficult to determine within a nearly complete digitalized business activity as such as the SMNE. The SMNE carries out two main economical activities within the jurisdiction of the Market State: the collection of raw user data and the display of personalized advertisements on the newsfeeds of users located in the Market State. The two main factors of value of the SMNE is therefore the size and variety of the data pool, thus the actual size of the network itself[88] and the actual quantity of collected and monetized user data.[89]

The question is whether the collected user data by itself has value or if there must be some kind of monetizing to create value. Some public consultants of the OECD claim that raw data itself does not have value[90] because the data itself already exists and needs therefore some kind of processing to create value.[91] This view is not convincing. Assuming the digital economy cannot be ring-fenced,[92] the included business models and assets must be treated with the same rules and principles as traditional business models.[93] The assumption that raw data does not have value by itself, would lead to the conclusion, that all raw materials (even air, water or mineral resources) would not have value by itself.[94] This conclusion would be contrary to international accounting and tax principles.[95] Therefore, it seems to be consistent to grant raw data value by itself and to take into account the

[86] European Commission, COM (2018) 148 Final-2018/0073 (CNS), p.3/4, p.23 no.41.
[87] The European Commission, "Communication from the Commission to the European Parliament and the Council – A Fair and efficient tax system in the European Union for the Digital Single Market" (21.09.2017), COM (2017) 547 final, p. 7.
[88] OECD, "Tax Challenges Arising from Digitalization – Interim Report 2018", Chapter 2.4.1, p. 46, no. 110 and 111.
[89] Ibid. No.88 at no. 109.
[90] OECD,"Tax Challenges of Digitalization-Comments Received on the Request for Input" (2017), Part I, p.37-38.
[91] Ibid. No.90 at p.139.
[92] OECD, "Addressing the Tax Challenges of the Digital economy", BEPS Project 2015, Action 1: Final Report, p. 11 and p. 54 no.115; W.Schön, "Ten Questions about Why and How to tax the Digital economy", Bulletin for International Taxation 2018 Vol. 72 (No.4/5), p. 280-281, Chapter 2.
[93] OECD, "Addressing the Tax Challenges of the Digital economy", BEPS Project 2015, Action 1: Final Report, p. 11 and p. 54 no.115; W.Schön, "Ten Questions about Why and How to tax the Digital economy", Bulletin for International Taxation 2018 Vol. 72 (No.4/5), p. 280-281, Chapter 2.
[94] S. De Jong/W.Neuvel/A.Uceda, "Dealing with Data in a Digital economy", Bulletin for International Taxation 2018 Vol. 72 (No.11), Chapter 5.3., p.59.
[95] Ibid. No. 94.

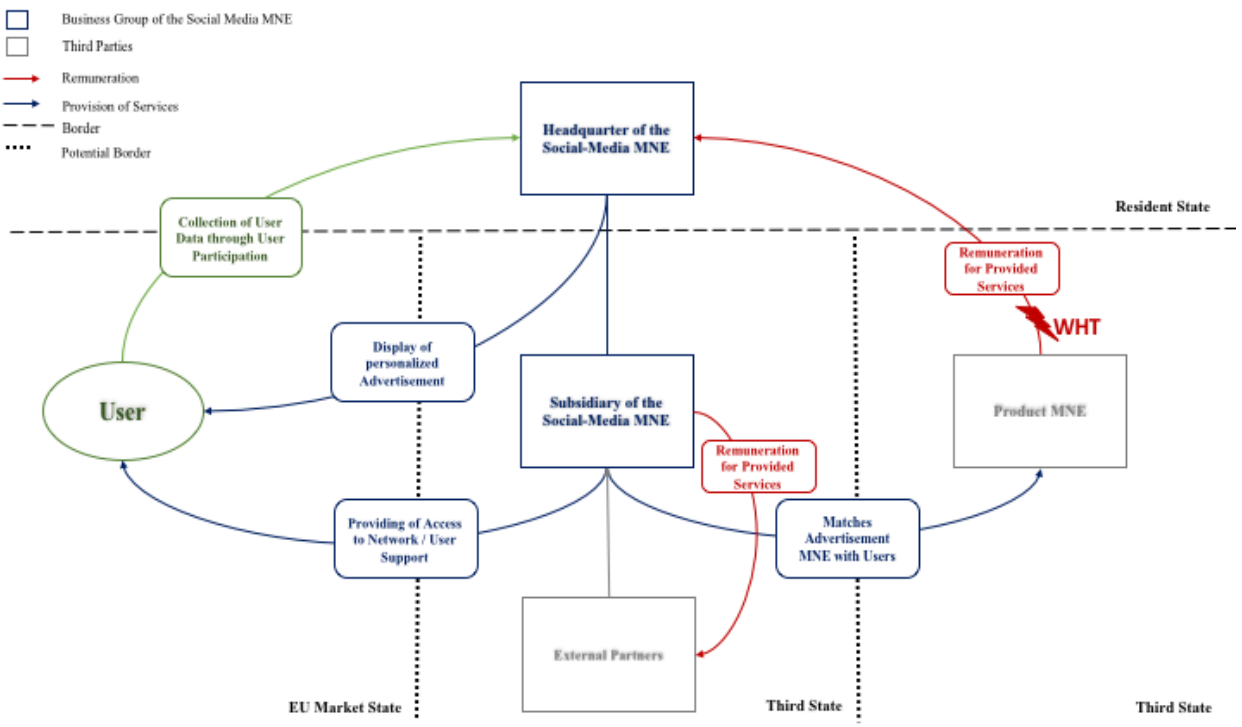
different stages[96] where the user data are processed and monetized for any value chain analysis.[97] Hence, the state where the user data is collected and the personalized advertisement is displayed (in this example: the Market State) is also deemed to be the place of value creation.

As already elaborated the current CIT-system is based on the legal principle of physical presence and due to the missing physical presence within the Market State, there is no possibility for the Market State to tax the income of the SMNE sourced within its territory.[98] The Market State aims to establish a taxation right on the income of the SMNE outside of the scope of the current domestic CIT-system. An abstract construct of PE, value creation or physical presence is not necessary. Within a WHT-scheme the tax is collected at the source of the income in question.[99] Consequently it only requires a financial transaction. In the case of the SMNE this income includes every received payment for the digital advertisement services such as selling digital advertisement space and displaying the personalized advertisements. Consequently, the SMNE needs to generate some kind of income from the jurisdiction of the Market State.

3.3.2.1 Scenario I:

In the first scenario the PMNE is not located in the same jurisdiction where the data collection and the display of the personalized advertisement takes place. Problematic in this context is that in the shown business model financial transactions are only taking place between the SMNE and the PMNE, not between the users and the SMNE:[100]

[96] About the value creation chain regarding the usage of data: P.Valente, "The Data Economy: On Evaluation and Taxation", European Taxation 2019 (Vol.59 No.5)Chapter 3 and 4, p. 253-255.
[97] Ibid. No. 90 at p.127 and p.178.
[98] OECD, "Addressing the Tax Challenges of the Digital economy", BEPS Project 2015, Action 1: Final Report, p. 11, Executive Summary and p. 16.; OECD, "Tax Challenges Arising from Digitalization – Interim Report 2018", Chapter 2.5.1, p. 51, no.132.
[99] C.Lee,/J. Yoon, "IFA Cahiers Report 2018 on Withholding Tax in the Era of BEPS, CIVs and Digital economy", General Report (Vol. 103B), p.7, Introduction: Background.
[100] The following figure is drafted by the author based on the already presented OECD figure.



The SMNE is providing services in form of displaying the personalized advertisements for targeted users on the purchased spaces for the contracting partners in the Market State, as well as collecting user data and therefore generating value[101] from this jurisdiction. Thus, the SMNE is economically present in the Market State without any physical presence in this jurisdiction and also not generating any income from the Market State. The only taxable financial transaction concerning the targeted entity is the paid remuneration by the PMNE. The payment based on the contractual relation between the the two parties is included in the taxable income of the SMNE and will be taxed on the level of the SMNE in the Resident State. Regardless, this payment has no connection to the Market State and does not establish any link for the Market State to tax the income of the SMNE. To levy a WHT on the payment between the local Subsidiary of the SMNE towards the external partner would miss the original target to tax the income of the SMNE. In this context the tax object would be the income of the external partner and not the income of the SMNE.

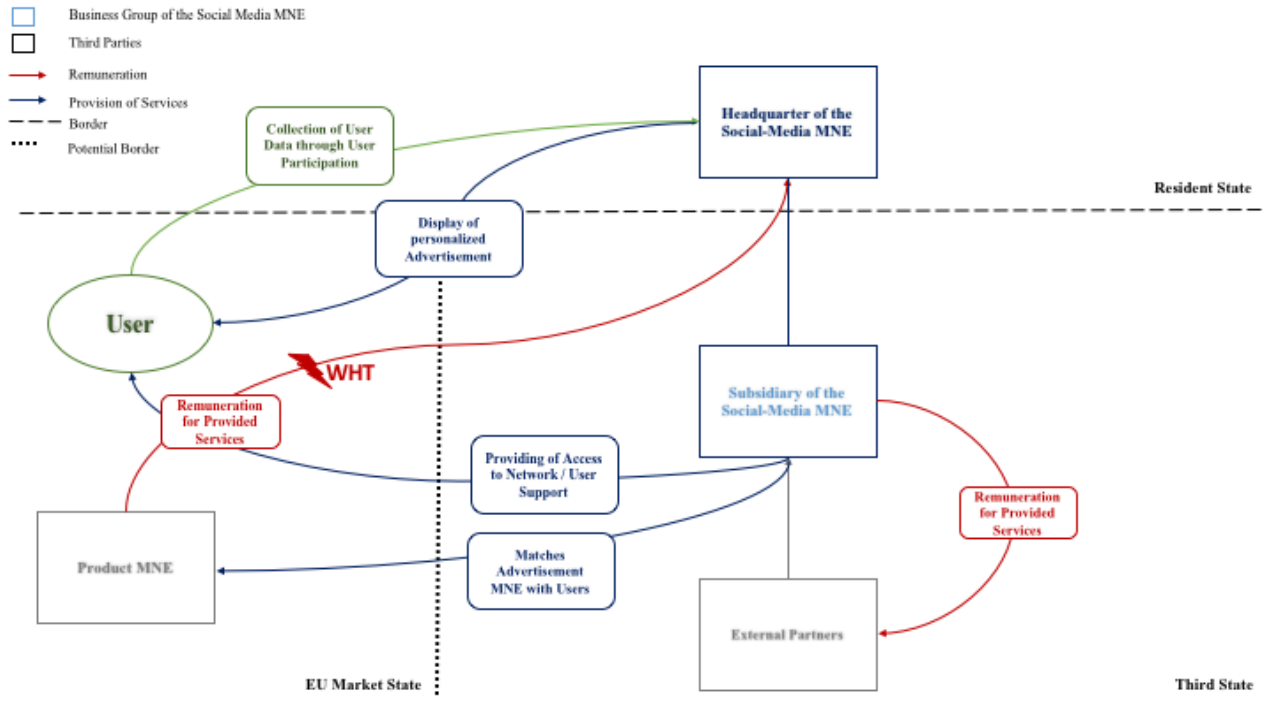
In the first scenario it is not impossible for the Market State to levy a WHT on the income of the SMNE, due to the lack of generated income sourced from the jurisdiction of the Market State. Even though the SMNE is economically present and creating value in the Market State. In this case, the

[101] A. Dourado, „Digital Taxation Opens the Pandora Box: The OECD Interim Report and the European Commission Proposals", INTERATX 2018 Vol. 46 (Issue 6&7); S. De Jong/W.Neuvel/A.Uceda, "Dealing with Data in a Digital economy", Bulletin for International Taxation 2018 Vol. 72 (No.11); M. Olbert/C.Spengel, „International Taxation in the Digital economy: Challenge Accepted?", World Tax Journal 2017 (Vol.9 No.1), p. 9-10.

implementation of such WHT within the jurisdiction of the Market State would not solve the problem of missing taxation rights over the income of the SMNE for the Market State.

3.3.2.2 Scenario II:

In the second scenario the PMNE is located in the same jurisdiction as the data collection and the provision of the digital advertisement service takes place:[102]



In this case, the SMNE is economical presence in the Market State without any physical presence in this jurisdiction, but generates income from the Market State based on the contractual relation with the PMNE. In this scenario, the SMNE generates income sourced within the jurisdiction of the Market State. The Market State is therefore able to levy a WHT on the payment from the PMNE. Even though in this scenario the problem of missing taxation rights over the income of the SMNE for the Market State is solved, the WHT only taxes the gross income of the SMNE and does not tax any value creation regarding the user data sourced from the Market State.

3.3.2.3 Interim Conclusion: Tax Object

The previous analysis shows, that the tax object of the WHT is not the construct of value creation originating from the business activity of the SMNE in the Market State. The tax object is only the received remuneration, without any value-determination. As a result, the tax object of the WHT is the income generated by a non-resident SMNE from providing digital advertisement services for a domestic taxpayer of the Market State.

[102] The following figure is drafted by the author based on the already presented OECD figure.

3.3.3 Tax Subject

Tax subject of the WHT is neither the network user, nor the PMNE. The Market State where the user data are collected and the personalized advertisements are displayed aims to tax the income of the SMNE.

The Commission reasoned, that based on the complex and diverse domestic civil law and CIT-systems it is pertinent, to establish a wide scope of the WHT-tax-subject, regardless of the particular legal form or wherever the entity is treated transparent for tax purposes.[103] Otherwise, the multinational enterprises has the possibility to choose the legal form for its entity which is explicitly outside the scope of such WHT. Furthermore the OECD issued, that digital multinational enterprises with a high annual revenue are more likely to take advantages of tax base erosion and profit shifting, than small to medium sized multinational enterprises.[104] According to the OECD and the Commission it is expedient to diminish the impact of the WHT on small to medium sized businesses.[105] And as well to simplify the application of the WHT by establishing certain thresholds.[106] These thresholds can be based on the overall size and worldwide annual revenue of the SMNE[107] or on the generated revenue by provided digital services within the specific jurisdictions.[108]

To target domestic SMNE with the WHT is not expedient because these entities are already located within the jurisdiction of the Market State and therefore residents for tax purposes. Thus, these SMNEs are already registered for tax purposes and are obligated to file in tax returns and pay the CIT in the Market State. For these entities the Market State is not missing any taxation rights. The argumentation is also applicable if the SMNE is located outside of the Market State, but maintains a PE within the jurisdiction of the Market State. On these grounds it is purposeful to levy the WHT only on non-resident SMNEs without a PE in the territory of the Market State.

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[103] Art. 2 and Art. 4 of the DST-Directive; European Commission, COM (2018) 148 Final-2018/0073 (CNS), p.10/24.
[104] European Commission, COM (2018) 148 Final-2018/0073 (CNS), p.10; European Commission, „Impact Assessment" (21.03.2018), SWD (2018) 81 final/2, p.67, no.4.
[105] OECD "Tax Challenges Arising from Digitalization – Interim Report 2018" (2018), p. 187, no. 450; European Commission, COM (2018) 148 Final-2018/0073 (CNS), p. 10-11.
[106] Ibid. No.106.
[107] E.G..: European DST: Art. 4 para. 1 no. a of the DST-Directive; European Commission, COM (2018) 148 Final-2018/0073 (CNS), p. 25.
[108] E.G.: European DST: Art. 4 para. 1 no. b of the DST-Directive; European Commission, COM (2018) 148 Final-2018/0073 (CNS), p. 25; Content and structure of the Indian Equalization Tax: S.Wagh "The Taxation of Digital Transactions in India: The new Equalization Levy" (2016), Bulletin for International Taxation 2016, Volume 70 (No.9), p.549.

3.3.4 Tax Base

Based on the fact, that the SMNE is a non-resident and the Market State is not in a suitable position to identify net income of an isolated transaction, the WHT should be in this context a final tax[109] on the gross income of the SMNE.[110] In this sense, the tax base in this scenario is thus the paid remuneration for the provided digital advertisement services, without the deduction of any related expenses. Although dependent on the jurisdiction of the Market State, an automated presumptive or standard deduction might be granted.[111]

3.3.5 Tax Collection

In the proposed structure the PMNE paying the remuneration to the SMNE acts as the "withholding agent". The PMNE withholds a certain tax portion of the amount paid to the SMNE and transfers it to the domestic tax authorities of the Market State on the account of the SMNE.[112] How much the withholding agent actually withholds depends on the WHT-rate determined by the Market State.

3.3.6 Tax Burden

Based on the WHT-system the PMNE will deduct the WHT portion from the claimed purchase price and the SMNE will receive a reduced purchase price (tax wedge).[113] In this way the statutory incidence[114] of the WHT is burdened by the SMNE and not by the network users or the PMNE. The question is, whether the tax burden will be actually carried by the SMNE or whether the economic incidence of the WHT will be shifted to another

[109] Y.Brauner/A. Baez, "Withholding Taxes in the Service of BEPS Action 1: Adress the Tax Challenges of the Digital Economy, IBFD-Workingpaper, 02.02.2015, Chapter 5.3., p. 21.
[110] C.Lee,/J. Yoon, "IFA Cahiers Report 2018 on Withholding Tax in the Era of BEPS, CIVs and Digital economy", General Report (Vol. 103B), p.21, Chapter II.2.6.
[111] Ibid. No.110 at p.21, Chapter II.2.6.
[112] Ibid. No.110 at p.7, Introduction: Background.
[113] Tax wedge is tax-induced difference between the paid price by the consumer and the price received by the supplyers: H.Rosen/T.Gayer in „Public Finance", Vol. 8 (2007), Chapter 15, p. 312.
[114] Statutory incidence of a tax indicates, who is legally responsible for the tax: H.Rosen/T.Gayer in „Public Finance", Vol. 8 (2007), Chapter 15, p. 304.

party.[115] The answer is depending on the demand[116] and supply[117] elasticity of the service in question.[118]

In case the supply of such digital advertisement services is perfectly inelastic,[119] the price received by the SMNE (the producer) would decrease exactly by the amount of the WHT. Therefore, the SMNE as the producer would bear the entire burden of the WHT.[120] In case the supply of digital advertisement services is perfectly elastic,[121] the price paid by the PMNE (the consumer) would increase exactly by the amount of the WHT. Thus the PMNE as a consumer would bear the entire burden of the WHT.[122] Since the digital advertisement services are neither basic consumables like food,[123] nor particular luxury goods,[124] but ordinary goods of the international market and hence covered by common business rivalry. The elasticity of the demand and supply curve cannot be identified from the outset. Hence, to conclude which party is actually bearing the tax burden of the WHT, the elasticity of demand and supply of the market for digital advertisement services must be determined. This quest would require a detailed analysis of such market. This task would go beyond the scope of the thesis. However, it can be summarized, that in case that the demand curve is more elastic and it is easier for the PMNE to turn to another advertisement product when the purchase price rises, the WHT will be borne less by the PMNE. In case the supply curve is more elastic and the PMNEs are purchasing the same amount of digital advertisement services regardless of the purchase price, the economic incidence of the WHT would be shifted to the PMNE.[125]

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[115] Econcomic incidence of a tax indicates the distribution of real income induced by a tax: Ibid. No.114 at p. 304-305.

[116] Elasticity of Demand: shows how sensitive the consumer of a good are to changes in the economy like purchase prices, a high elasticity of demand means that the consumer are more responsive to changes in the purchase price, in case of a higher purchase prices the demand increases and the other way around; D.Hyman, "Public Finance- A Contemporary Application of Theory to Policy", eBook, Vol.10, Part I, Chapter 1, p.44-46 and Online Source the Financial Dictionary, last access 23.04.2019: https://financial-dictionary.thefreedictionary.com/elasticity+of+demand.

[117] Elasticity of Supply: shows how sensitive the producer of a good are responding in changes of the price of that good, high elasticity means that e.g.: a rise in price leads to a increase of supply and the other way around or that the rise of the purchase price does not have any or only a small effect of the supply at all; C.f.: D.Hyman, "Public Finance- A Contemporary Application of Theory to Policy", eBook, Vol.10, Part I, Chapter 1, p.54-56 and Online Source the Financial Dictionary, last access 23.04.2019: https://financial-dictionary.thefreedictionary.com/elasticity+of+supply.

[118] Ibid. No.114 at Chapter 15, p. 312.

[119] The rise of the purchase price has no effect on the amount of the digital advertisements services that the SMNE produces/supplies: Online Source the Financial Dictionary, last access 23.04.2019: https://financial-dictionary.thefreedictionary.com/elasticity+of+supply.

[120] Ibid. No.114 at Chapter 15, p. 313, Figure 14.4.

[121] The rise of the purchase price would lead to an increase of supply of the advertisement services that the SMNE produces/supplies: Ibid. No.119.

[122] Ibid. No.114 at Chapter 15, p. 313, Figure 14.5.

[123] Food is most likely to be subject to a low degree of elasticity of demand and supply: C.F: Online Source the Financial Dictionary, last access 23.04.2019: https://financial-dictionary.thefreedictionary.com/elasticity+of+supply and https://financial-dictionary.thefreedictionary.com/elasticity+of+demand.

[124] Luxuray goods are most likely to be subject to a high degree of elasticity of demand and supply: Ibid. No.123.

[125] Conclusion of Ibid. No.114 at Chapter 15, p. 312.

3.4 Interim Conclusion: Implementation of the WHT-System

It can be summarized, that a tax object is only present within the jurisdiction of the Market State, if the PMNE is also located in that state. In case that the PMNE is located in a third jurisdiction, the Market State cannot implement a WHT, based on the lack of generated income sourced from the domestic jurisdiction. Due to the ongoing globalization and digitalisation of the economy it is not uncommon that the contractual partner of the SMNE is located in a third jurisdiction and not in the Market State. It can be assumed, that even if the Market State implements a WHT on payments for certain digital advertisement services, the majority of the income of the SMNE will not be covered by such tax. Hence, the income remains still untaxed. Furthermore, the WHT-system is also not able to tax the actual value creation generated by collected user data in the jurisdiction of the Market State.

In conclusion, the implementation of the described WHT-scheme levied on certain digital advertisement services of a non-resident SMNE falls short to solve the current problem of missing taxation rights for the Market State. Moreover, the implementation of such WHT bears also the risk that the actual economic incidence of the WHT would be carried by the PMNE and not by the targeted SMNE.

4 Compliance with European Law

Various Member States of the EU want to pursue the establishment of a domestic tax on certain digital transactions.[126] Although the legislation concerning direct taxation falls within the shared competence of the Member States,[127] it must be exercised consistently with EU-Law.[128]

4.1 Comparability with the European VAT-System

Art. 401 of the VAT-Directive[129] prohibits the Member State to implement a national tax on the supply of goods and services which is comparable to VAT and/or jeopardises the common VAT-system. Hence, it is important, to determine whether the introduced WHT is comparable to VAT and whether this tax would jeopardise the function of the common European VAT-system.[130]To determine whether the WHT is a comparable tax to VAT, four essential characteristics must be met: the tax applies generally to

[126] European Commission, „Impact Assessment“, (21.03.2018), SWD (2018) 81 final/2, p. 54.
[127] The EU only owns the exclusive competence regarding indirect taxation: Art. 3 TFEU and 110 TFEU.
[128] Judgement of 14.02.1995, “Schumacker”, C-279/93; EU:C:1995:31, para. 21 with further references.
[129] Article 401 of the Council Directive 2006/112/EC of 28.11.2006 (OJ L 347; 11.12.2006) as amended.
[130] Judgement of 03.10.2006, “Banca Popolare Di Cremona”, C-475/03. EU:C:2006:629, para. 25.

transactions relating to goods and services; the levied tax is proportional to the actual purchase price; the tax is charged on each stage of the production and distribution; the amount paid during the preceding states is deductible from the final payable tax of each taxpayer and the final burden of the tax rests ultimately on the final consumer.[131]

First, the WHT is only levied on a percentage of the paid purchase price for digital advertisement services of a SMNE located abroad. The WHT would thus be a tax applicable to transaction relating to certain services. Moreover, would the WHT be levied on a certain percentage depending on the paid remuneration. The tax would therefore be proportionate to the actual purchase price. These attributes of the WHT are hence comparable to VAT.

Secondly, the WHT is charged on every single transaction concerning these specific digital advertisement services, as long as the SMNE receives a remuneration. But the tax is not charged on each state of production or distribution. The WHT is only charged once, on the overall purchase price for the digital advertisement services, paid by the end consumer (the PMNE). Accordingly, this attribute of the WHT is not comparable to VAT.

Third, the final tax burden of the VAT is levied on the tax subject (the SMNE), even though the consumer (the PMNE) is acting as a withholding agent. The tax burden is targeting the income of the SMNE, in the way, that the SMNE will receive a reduced purchase price due to the withheld WHT-portion. Hence, the WHT is designed to tax the partial income of the SMNE and not as a consumption tax targeting the consumer.[132]The WHT is thus also concerning the tax burden not comparable to the VAT. Lastly, a kind of input-deduction for the tax subject is also not a part of a WHT-System. As a result, this requirement of VAT is also not fulfilled by the WHT.

Consequently, the WHT would not meet the essential characteristics of VAT and is therefore not a comparable tax[133] to VAT. As a consequence, the WHT would also not interfere with the VAT-System of the EU. The implementation of such WHT is therefore not opposed by Art. 401 of the VAT-Directive.

4.2 Freedom of Establishment (Art. 49 TFEU)[134]

Furthermore, it needs to be analysed whether the enforcement of the WHT establishes an infringement of the fundamental freedoms of the TFEU. It

[131] Judgement of 08.06.1999, "Pelzl and Others" (joined cases), C-338/97. EU:C:1999:285, para. 21.
[132] C.f.: Ibid. No.131 at para. 24 and Ibid. No.130 at para.32-35.
[133] C.f.: Ibid. No.130 at para.30-38.
[134] Art. 49 of the Treaty of the Functioning of the European Union, The European Union, "Consolidated Version of the Treaty of the Functioning of the European Union", Official Journal of the European Union (C 326/47).

should be noted, that this analysis is following the assumption, that the WHT would only be applicable for foreign SMNEs. Otherwise the purpose of the illustrated WHT would be missed.[135] According to the exact wording of Art. 49 TFEU the freedom of establishment is only applicable to nationals of a Member State within the territory of the EU. Assuming the Market State, the PMNE, the SMNE and its subsidiaries are located within the territory of the EU an infringement of Art. 49 TFEU must by analysed.

4.2.1 Scope

The freedom of establishment grants EU-nationals the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, but only under the conditions laid down by the law of the Member State where such establishment is effected.[136] For companies or firms formed in accordance with the law of a Member State and having their registered office within the EU, this fundamental freedom establishes the right to exercise their activity in the Member State concerned through a subsidiary, a branch or an agency.[137] In case of companies, the registered office serves as the connecting factor for the legal system of the concerned Member State.[138] Moreover, does the freedom of establishment aim to guarantee the benefit of national treatment in the host Member State, by prohibiting any discrimination based on the place in which the companies have their seats.[139]

In the present scenario, the WHT on digital advertisement services is only charged on remuneration paid to non-residents. Whereas the WHT is not charged on remuneration paid to domestic taxpayers. The procedure for charging the WHT varies depending on the place where the SMNE maintains its registered office. Thus, the Market State makes the tax treatment directly dependent on the fact, where the SMNE has established its registered office. The relevant fundamental freedom is consequently the fundamental freedom of establishment.

It must be noted, that even the circumstance that the location of SMNE or its subsidiaries was chosen only for the purpose of benefitting from a more favourable CIT-regime or for tax planning does not preclude the reliance of the SMNE on Art. 49 TFEU.[140] Nonetheless, in case the SMNE takes fraudulently advantage of the provisions and the tax law system of its Resident State, the company cannot rely on the exercise of the fundamental

[135] See analysis in Chapter 3.3.3. of this thesis.
[136] Judgement of 13.12.2005, „Marks & Spencer PLC“, C-446/03, EU:C:2005:201, para. 30.
[137] Ibid. No.136.
[138] Judgement of 22.12.2008, „Truck Center“, C-282/07, EU:C:2008:762, para. 32 with further references.
[139] Ibid. No.138.
[140] Judgement of 12.09.2006, „Cadburry Schweppes“, C-196/04, EU:C:2006:544, para. 37-38.

freedom in question.[141] It should be assumed, that the SMNE choose the Resident State because of a beneficiary CIT-system, without any abusive or fraudulent tax practices. The pictured scenario falls accordingly under the scope of the fundamental freedom of establishment.

4.2.2 Restriction

According to the settled case-law all measures which prohibit, impede or render the exercise of the freedom of establishment less attractive are constituting are restriction of this fundamental freedom.[142]In the present case, the WHT on digital advertisement services is only charged on remuneration paid to non-residents. Whereas the WHT is not charged on remuneration paid to domestic taxpayers. In conclusion only the income of non-resident SMNEs is burdened with this tax. In turn, the income of domestic SMNEs is not affected. These circumstances render the exercise of the freedom of establishment less financially attractive within the jurisdiction of the Market State for non-residents. The exercise of the freedom of establishment is therefore restricted by the different tax treatment.

4.2.3 Discrimination

According to well-established case-law, discrimination is defined as treating identical situation differently or treating different situations in the same way.[143] In order to determine whether a difference in the tax treatment is discriminatory, it must be analysed whether the concerned companies are in objectively comparable situations.[144] In relation to direct taxes the situations of residents and non-residents, are as a rule, not comparable.[145] Consequently the different tax treatment of residents and non-residents cannot in itself be categorised as discrimination within the meaning of the TFEU.[146] Despite that rule, the situation of non-resident and resident SMNEs, would become comparable, in case that both entities were subject to the WHT and only the domestic SMNEs get benefits grated based on their residency in the Market State.[147] For that reason, it is necessary to examine whether that is also the position in the scenario at hand.

Firstly, it must be noted, that the foreign SMNE is economically present within the Market State, but does not maintain a PE in that state, nor is it physically present within that territory. Therefore, that SMNE is not a

[141]Ibid. No.140 at para. 35; Judgement 26.02.2019, „T Danmark“, C-116/16 (joined cases), EU:C:2019:135, para.96 with further references.
[142] Judgement of 31.03.1993, „Kraus“, C-19/92, EU:C:1993:125, para. 32.
[143] Ibid. No.128 at para.30; Judgement of 11.08.1995, „Wielockx“, C-80/94, EU:C:1995:271, para. 17; Ibid. 138 at para. 37 with further references.
[144] Judgement of 12.12.2006, „Test Claimants“, C-374/04, EU:C:2006:139, para. 46.
[145] Ibid. No.128 at para.31.
[146] Judgement of 11.08.1995, „Wielockx“, C-80/94, EU:C:1995:271, para. 19.
[147] Judgement of 17.09.2015, „ Miljoen“, C-10/14 (joined cases), EC:C:2015:608, para.67.

resident for tax purposes regarding the Market State. Whereas the domestic SMNE is a resident for tax purposes of that Market State. Based on the sovereignty of the Member States of the EU both entities are subject to completely different tax systems, legislations and jurisprudence. This circumstance implies, that the situations of resident and non-resident SMNEs are not objectively comparable.

Furthermore, is the WHT explicitly applicable on the income of non-resident SMNEs sourced within the territory of the Market State by providing certain digital advertisement services in that jurisdiction. The income of the resident SMNE sourced within the territory of the Market State, by the provision of such digital advertisement services is excluded. Concerning the resident SMNE, the company is registered for tax purposes in the Market State and the domestic CIT-system readily applies. Accordingly, the overall income of the resident SMNE is subject to the CIT-system of the Market State and and no taxation rights are missing for that state. In this case the Market State is able to determine the personal ability to pay of the SMNE by referencing to the generated overall income and the economical circumstances of the entity. Whereas this kind of determination is not possible for the Market State when the recipient of the income in question is located abroad.[148] In this situation the income received in the territory of the Market State by a non-resident is only a mere fraction of its overall income. Consequently, the resident SMNE is taxed on its total income, while the non-resident is only taxed on the income arising from the service remuneration paid in the Market State.[149] Thus, the domestic SMNE and the non-resident SMNE are not in comparable situations regarding the taxable income within the Market State. The difference regarding the tax treatment is therefore based on the implementation of two different tax regimes: the application of the domestic CIT-regime for residents and the application of the WHT-regime for non residents. Hence, the charged taxes rest on a separate legal basis.[150] The difference in the tax treatment is thus not caused by a favourable treatment of domestic entities over foreign entities within the same tax regime. The application of two different tax-regimes within the Market State, without any intersections or common reference points speaks for a non-comparable situation for the resident SMNEs and non-resident SMNE.

Moreover, does the different tax treatment resulting in a tax burden in form of a WHT for the non-resident SMNE, not necessarily establishes a tax advantage for the resident taxpayer. The domestic SMNEs are obligated to file in tax returns, comply with the domestic tax law and accounting

[148] Ibid. No.128 at para.32.
[149] Ibid. No.147 at para.66.
[150] Argumentation of Ibid. No.128 at para.42-48.

obligations. Additionally, the domestic SMNE are actually paying CIT in the Market State. Whereas non-resident SMNE are not required to do so. It can be assumed the the obligation to comply with domestic accounting standards, to submit the annual tax return and to pay CIT, will result in a higher financial burden for the tax residents of the Market State, than the actual financial burden of the non-resident SMNE triggered by the WHT.[151]

Those circumstances reflect that the different situations of non-resident SMNEs and domestic SMNEs, are not objectively comparable. Hence, the different tax treatment of residents and non-residents does not constitute a discriminatory restriction of the exercise of the freedom of establishment.

4.3 Free Movement of Capital (Art. 63 TFEU)

In the scenario, where the Market State and the PMNE are located within the territory of the EU, but the SMNE and its Subsidiaries are located within the jurisdiction of a third non-EU country, the only applicable fundamental freedom is the free movement of capital and payments.[152] In this case, the aforementioned conclusion is also applicable. The different tax treatment of non-resident SMNEs and domestic SMNEs does not constitute a discrimination.[153]

4.4 State Aid

It must also be analysed whether the newly implemented WHT constitutes prohibited state aid in the light of Art. 107 para.1 of the TFEU.[154] Pursuant to Art. 107 para. 1 of the TFEU the measure, which qualifies as prohibited state aid, must cumulatively met the following conditions: the measure has to be granted out of state resources, while conferring a selective economic advantage to certain undertakings, what leads to a disorted competition by affecting the intra EU trade.[155]

4.4.1 Undertaking

The term "undertaking" covers any entity engaged in an economic activity, regardless of its legal status and the way how it is financed.[156] In the pictured scenario the concerned undertakings are the domestic SMNEs and

[151] Argumentation of Ibid. No.128 at para.49.
[152] The wording of Art.63 of the Treaty of the Functioning of the European Union, The European Union, "Consolidated Version of the Treaty of the Functioning of the European Union", Official Journal of the European Union (C 326/47) explicitly opens the scope of this fundamental freedom for third country scenarios.
[153] C.f.: Judgement of 12.12.2006, „Test Claimants", C-446/04, EU:C:2006:774, para. 60; Ibid. No.138 at para. 51 with further references.
[154] Art. 107 of the Treaty of the Functioning of the European Union, The European Union, "Consolidated Version of the Treaty of the Functioning of the European Union", Official Journal of the European Union (C 326/47).
[155] Decision of the Commission of 07.11.2012, SA.34466 (2012/N), „Cyprus", para.18/19.
[156] S.Douma in „European Tax Law", P. Wattel ed., Wolter Kluwer 2018, 7th Edition, Vol. I, Chapter 22, p.884 with futher references.

the foreign SMNEs. It must be analysed if the resident SMNEs or the non-resident SMNEs are receiving a selective economic advantage granted by state resources of the Market State.

4.4.2 State Resources

The qualification of a domestic measure as state aid in the scope of Art. 107 para. 1 TFEU requires, that there is an intervention by the state through state resources.[157] Since the the implementation of the tax would be a result from an act of the parliament of the Member State in question, it is clearly imputable to that state.[158] In the present case, the WHT would only apply to the income of non-resident SMNEs sourced within the jurisdiction of the Market State by providing certain digital advertisement services. Resident SMNEs providing the same kind of services within the territory of the Market State are not affected by that tax. The Market State waives resources it would otherwise have collected from domestic undertakings. As a result, this condition is fulfilled.[159]

4.4.3 Economic Advantage and Selectivity

The concept of European aid includes not only positive benefits or transactions, but also measures which make the financial situation of the undertaking more favourable than normal.[160] In the scenario at hand, the WHT would only apply to the income of non-resident SMNEs sourced within the jurisdiction of the Market State by providing certain digital advertisement services. In ths regard, only foreign entities are burdened with the tax. Domestic entities remain unaffected, even if the are providing the same services within the jurisdiction of the Market State. This measure could therefore constitute positive state aid for the resident SMNEs in comparison with non-resident SMNEs, providing the same kind of digital advertisement services within the territory of the such state. Here, the income of the resident SMNE generated by such certain digital services is only tax subject to the domestic CIT-system of the Market State. Whereas the income of the non-resident SMNE generated by the same kind of service is subject to the WHT in the Market State and the CIT-system in its Resident State. Therefore, the overall financial burden of the non-resident SMNE regarding the income generated from the Market State is higher than for the domestic company. The resident SMNEs providing digital advertisement services are granted a tax benefit because they are not subject to the additional tax on certain digital services.

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[157] Ibid. No.156 at p.886.
[158] Decision of the Commission of 30.07.2014, SA.39235 (2015/NN), „Hungarian Advertisement Tax“, para.41.
[159] Ibid. No.158 at para.42.
[160] Judgement of 08.11.2001, „Adria-Wien-Pipeline“, C-143/99, EU:C:2001:598, para. 38.

It must be examined, whether such tax advantage is selective. The selectivity of such advantage is based on the comparison between the two groups, who benefits from the tax scheme and those which do not, within the same reference framework.[161] The advantage is selective under a particular statutory scheme, if the state's measure favours certain undertakings or the production of certain goods in comparison with other undertakings which are in a legal and factual situation that is objectively comparable.[162] However, it must be noted, that the concept of state aid does not refer to state measures where the different treatment arises from the nature or the overall structure of the domestic tax system.[163]

In order to classify whether the domestic tax measure as selective, it is necessary to begin by identifying and examining the common tax regime applicable in the concerned Member State and whether the measure in question derogates from that regime.[164]In the scenario at hand the comparable groups are the resident SMNEs and the non-resident SMNEs. The applicable reference system for such cross-border situations is the general domestic CIT-system of the Market State.[165] Based on the CIT-system of the Market State entities with some kind of physical presence are subject to the CIT in this jurisdiction. With the implemented WHT even non-resident entities without any physical presence within the jurisdiction of the Market State are subject to a tax imposed by the Market State. In turn, resident companies with physical presence in that jurisdiction, providing the same kind of services, are excluded from that WHT. This derogates the common CIT-system of the Market State. This derogation could be justified by the nature or the general system of the underlying tax scheme.[166] Hence, it is questionable if the legal and factual situation of a non-resident company and a resident company is objectively comparable regarding the nature and general scheme of the CIT-system of the Market State. The domestic SMNEs are economically and physically present in the Market State and generating income from that jurisdiction, while paying CIT. In contrast the non-resident SMNEs are only economically present in the Market State without being physically present. In addition, these entities do not pay taxes within that jurisdiction. Based on these circumstances the Market State can directly tax the income in question of resident SMNES by applying the domestic CIT-system. In turn, the Market State cannot apply the domestic CIT-system and therefore cannot tax the income of non- resident SMNES

[161] Judgement of 06.09.2006, „Portugal vs. Commission", C-88/03, EU:C:2006:511, para. 22.
[162] Judgement of 07.11.2014, „Autogrill España SA", T-219/10, EU:T:2014:939, para. 29 with further references.
[163] Ibid. No. 161 at para. 52.
[164] Ibid. No.162 at para. 33 with further references.
[165] C.f.: Ibid. No. 162 at para. 50.
[166] Commission Notice on the Notion of State Aid as referred to in Article 107 (1) oft he Treaty on the Functioning of the European Union (19.07.2016), Official Journal of the European Union (2016/C 262/01), para. 138/139.

sourced within its jurisdiction, due to the lack of physical presence. Consequently, the difference in the tax treatment is thus based on the application of two different tax-schemes: the domestic CIT-regime for residents and the WHT-regime for non-residents. Accordingly, the different treatment is justified by the nature and the general system of the underlying domestic CIT- scheme. Consequently, resident and non-resident SMNEs are not in a legal or factual situation which is objectively comparable.[167]

Based on the lack of selectivity, does the WHT not constitutes prohibited state aid in the light of the Art. 107 para.1 TFEU.

4.5 Interim Conclusion: Compliance with EU-Law

The implementation of a WHT on a national level within the Market State, levied on income arising from certain digital advertisement services, received by non-resident SMNE does not interfere with the VAT-System of the EU. Neither does this tax constitute a discriminatory restriction of the exercise of the fundamental freedoms of establishment or the free movement of capital and payments. Furthermore, does the WHT not constitutes prohibited state aid pursuant to Art. 107 para.1 TFEU. The WHT is therefore in line with EU-Law.

5 Compliance with the OECD Model Convention

This chapter analysis, in which scenarios the newly implemented WHT could lead to double taxation issues and whether such tax falls under the scope of the OECD MC.

5.1 Risk of International Double Taxation

The implementation of a national WHT in the Market State, levied on income arising from certain digital advertisement services received by non-resident SMNE could lead to the following double taxation problems within cross-border-transactions:

The digital advertisement service can simultaneously be the tax object to the WHT in the Market State, as well as to a similar tax on digital advertisement services in the Resident State. This scenario would result in juridical double taxation of the same digital advertisement service within two different jurisdictions with two different taxes on the level of the SMNE.[168]

[167] Ibid. No. 162 at para. 73-76; Judgement of 15.11.2018, „RENV Autogrill España SA“, T-219/10, EU:T:2018:784, para. 140-149.

[168] Juridical double taxation appears only in cross-border situations and can be defined as the imposition on comparable taxes in two (or more) jurisdictions on the same tax subject regarding the same tax subject for identical taxing periods: OECD: “Model Tax Convention on Income and on Capital: Condensed Version 2017 and Commentary” (November 2017).Introduction Chapter, no. 1.

Also possible is the scenario where the digital advertisement services are tax object of the WHT in the Market State and the SMNE is tax subject to the national CIT-System in the Resident State. The SMNE is here required to pay CIT based on the generated worldwide income in the Resident State. In this case the same digital advertisement service is taxed by the WHT in the Market State and included in the domestic CIT-Base in the Resident State, without any possibility for the SMNE to deduct or credit the amount of the WHT from the CIT-Base.

Furthermore, double taxation can occur in case that the tax subject of such special tax on digital services differs. For instance, in the Market State the tax subject is the non-resident service provider, whereas in the Resident State the tax subject of that tax on digital advertisement services is the end consumer. In this case, the same income from digital advertisement services is taxed twice, regarding different tax subjects, which leads to economical double taxation.[169]

5.2 Scope of Art. 2 OECD MC

The aim of DTTs is the avoidance of double taxation or excessive taxation in order to reduce tax obstacles to cross-border trade, investments or services by allocating taxing rights.[170] As shown, the intended implementation of a WHT within the jurisdiction of the Market State gives rise to several risks of double taxation. These elucidated scenarios generally fit the purpose of DTTs. A DTT drafted after the OECD MC can only grant relief from the occurring double taxation, if the concerned tax fits the term of covered taxes of the OECD MC. Consequently, it must be determined whether the WHT would fall within the scope of the Art. 2 OECD MC. The scope of included taxes is intentionally broadly drafted, to ensure an effective application of the DTTs and to avoid the necessity to sign a new DTT every time a tax is modified or newly implemented[171]. However, according to Art. 2 OECD MC the DTT only applies to taxes on income and capital[172] or elements thereof.[173] Art. 2 para. 3 OECD MC additionally includes a declaratory[174] and non-exhaustive list of taxes, where the contracting states can determine which tax should be covered by the DTT in any means.[175] This list is rendered dynamic by Art. 2 para. 4 OECD MC[176]

[169] Economical double taxation means, that the same item of income or capital is taxed in two (or more) jurisdictions during the same period, but in regard of a different tax subjects: OECD: "Model Tax Convention on Income and on Capital: Condensed Version 2017 and Commentary" (November 2017), p. 227, Commentary to Art. 9 para.2, no.5.
[170] OECD: "Model Tax Convention on Income and on Capital: Condensed Version 2017 and Commentary" (November 2017), p. 12, Introduction, no. 15.2-15.4.
[171] Ibid. No. 170 at Commentary acc. Art. 2, p. 91, no.1.
[172] Ibid. No. 170 at p. 28, Chapter I, Art.2 para.1.
[173] Ibid. No. 172 at para.2.
[174] Ibid. No. 170 at Commentary acc. Art.2 para.4, p.93, para.4 no.7.
[175] Ibid. No. 174 at para.3, p.92, para. 3, no. 6 and no.6.1.
[176] Ibid. No. 172 at para.4.

to provide the possibility to apply the DTT, without any adjustment to substantially similar taxes which are imposed after the conclusion of the DTT.[177]

5.3 Comparability to Other Taxes on Gross Income

Concerning the WHT, it is included in the scope of the DTT, as long as the tax is identical or substantially similar to an already imposed tax on income or capital in one of the contraction states or whether the legal nature of this WHT can be qualified as a tax on income or capital.[178] As indicated above, the WHT is implemented by the Market State to close existing gaps in the domestic tax law and to establish a legal basis for the Market State to tax the income of the non-resident SMNE sourced in the domestic territory. Hence, it is most likely that there is no identical or substantially similar tax on gross income already imposed in the Market State or the Resident State. Otherwise, there would be no need to implement a new tax such as the pictured WHT. Nonetheless, it can be argued that the WHT is charged as a special source taxation on a particular element of the cross-border income of the SMNE and therefore aims to charge the recipient of the income. This argumentation speaks for the nature of a tax on income.[179] Not at least because the gross taxation of income at the source is a common recognized mechanism within the international tax law under Art. 10[180] and Art. 11[181] of the OECD MC. Nevertheless, the payments received by the SMNE as remuneration for the supply of digital advertisement services do not fit the definition of "dividends" in the meaning of Art. 10 OECD MC.[182] Also the definition of "interests" in the meaning of the other acknowledged gross source taxation according to Art. 11 OECD MC is not met either.[183]

In conclusion, the WHT charged on payments received by the non-resident SMNE as remuneration for the supply of digital advertisement services is not an identical or substantially similar tax on gross.

[177] Ibid. No.174.
[178] M. Lang "Taxes covered-what is a tax according to Article 2 of the OECD Model?" (June 2005), Bulletin for International Taxation 2005 Volume 59, p. 221.
[179] R.Ismer/C.Jescheck "The Substantive Scope of Tax Treaties in a Post-BEPS World: Art. 2 OECD MC and the Rise of New Taxes" (2017), INTERTAX 2017 Volume 45, Issue 5, p. 385, Chapter 2.1; S.Wagh "The Taxation of Digital Transactions in India: The new Equalization Levy" (2016), Bulletin for International Taxation 2016, Volume 70 (No.9), p. 550.
[180] Ibid. No. 170 at p. 35, Chapter I, Art.10.
[181] Ibid. No. 170 at p. 36, Chapter I, Art.11.
[182] Ibid. No.170 at Commentary acc. Art. 10, p. 231, Preliminary Remarks, no. 1 and Commentary acc. 10 para.3, p.239-240, no. 23-27.
[183] Ibid. No. 170 at Commentary acc. Art. 11, p. 254, Preliminary Remarks, no. 1 and Commentary acc. 11 para.3, p.262-264, no. 18-21.

5.4 Legal Nature of the Tax

In order to qualify as a tax on income, the legal nature of the WHT must in its substance tax income.[184] Regardless of the aim of the tax, the label as turnover or excise tax or the willing of the legislator to exclude the tax from the scope of DTTs.[185] Generally, the focus of a tax on income lies on the recipient of the income and not on the payer[186] or the supply itself.[187] The fact, that the WHT is levied on the gross income through a withholding mechanism does not automatically disqualify the WHT as a tax on income, as long as the substance of the tax seeks to tax the business net income.[188]

5.4.1 Characteristics of the Tax

To determine the legal nature of the WHT, the examination of the actual characteristics of the tax and the relation to the present CIT-system is necessary. To elaborate how the characteristics of such tax can determine the legal nature of the tax, the WHT will be compared to the proposed European DST. It must be noted, that the proposed DST by its nature is not a WHT. This tax follows the principle of destination taxation[189] and is therefore not a source tax. Moreover, the proposal of the DST does not foresee a WHT-mechanism. This comparison is only used for this subchapter to illustrate, how the characteristics of a tax can impact the legal nature of a tax. It will be assumed, that the characteristics of the tax will be drafted after the DST-proposal within a WHT-mechanism.

In case that the WHT will be drafted based on the classical WHT-scheme, the WHT would be a source tax. The tax would be levied on the gross income of non-residents, taxed in the jurisdiction, where the income is generated by a withholding mechanism.[190] As already explained, it is not expedient to levy the WHT on domestic entities or on non-residents with a PE within the jurisdiction of the Market State. These entities would be excluded from the scope of the WHT. The WHT-burden is in this way directly linked to existing CIT-rules and ensures the application of this newly established tax without any collision of the domestic CIT-system.[191] The WHT would also permit a presumptive or standard deduction of a

[184] OECD "Tax Challenges Arising from Digitalization – Interim Report 2018" (2018), p. 182, no. 420-422.
[185] Ibid. No. 184 at p. 182, no. 422.
[186] R.Ismer/C.Jescheck "The Substantive Scope of Tax Treaties in a Post-BEPS World: Art. 2 OECD MC and the Rise of New Taxes" (2017), INTERTAX 2017 Volume 45, Issue 5, p. 384, Chapter 2.1.
[187] Ibid. No. 184 at p. 182, no. 420.
[188] Ibid. No. 187 at no. 419; D. Hohenwarter/G.Kofler/G.Mayr/J.Sinnig, "Qualification of the Digital Service Tax Under Tax Treaties" (2019), INTERTAX (Volume 47 Issue 2) p. 143.
[189] Report of the Commission Expert Group on Taxation of the Digital economy, European Commission (May 2014), p.5.
[190] C.Lee,/J. Yoon, "IFA Cahiers Report 2018 on Withholding Tax in the Era of BEPS, CIVs and Digital economy", General Report (Vol. 103B), p.7, Introduction: Background.
[191] Back-Stop mechanism of the Indian Digital Tax: S.Wagh "The Taxation of Digital Transactions in India: The new Equalization Levy" (2016), Bulletin for International Taxation 2016, Volume 70 (No.9), p. 550.

certain percentage of the income as an attempt to approximate the net income.[192] Through that attempted the tax takes the approximate profitability of the concrete digital transaction and the approximate economical position of the SMNE into consideration. Hence the tax claims to tax the net profit of the business. As a result, the WHT focuses on the recipient of the income and not on the service supply itself.[193] Thus, the WHT qualifies as a tax on income[194] and falls under the scope of Art. 2 OECD MC.

In case the WHT is drafted based on the model of the proposed DST,[195] the tax would be applicable to any legal entity or person, regardless of it tax residency or the particular legal form[196], as long as certain thresholds are exceeded.[197] The tax object would be the annual gross revenue,[198] obtained from special digital services provided by certain digital business models towards third parties.[199] The proposal also does not include any permission to deduct any related expenses or a presumptive or standard deductions.[200] Thus, the tax object of the DST is the revenue (turnover) of the tax subject. While the overall actual profitability of the concrete transaction and the actual economical position of the tax subject are irrelevant.[201] As a result such DST is imposed on the supply itself and does not focus on the supplier.[202] Based on the fact, that the DST would apply to domestic and non-resident SMNEs the proposal includes the possibility to deduct the already paid DST as costs from the CIT-base in the concerning Member State.[203] But this possibility does not provide a qualified link between the CIT-system and the DST. The right to deduct the paid DST as costs only reliefs the financial burden, but does not set the DST-burden in relation to

[192] Ibid. No.190 at p.21, Chapter II.2.6.
[193] Ibid. No.184 at p. 182, no. 420.
[194] R.Ismer/C.Jescheck "The Substantive Scope of Tax Treaties in a Post-BEPS World: Art. 2 OECD MC and the Rise of New Taxes" (2017), INTERTAX 2017 Volume 45, Issue 5, p. 385, Chapter 2.1; S.Wagh "The Taxation of Digital Transactions in India: The new Equalization Levy" (2016), Bulletin for International Taxation 2016, Volume 70 (No.9), p. 550.
[195] Detailed analysis whether the DST falls under the scope of the OECD MC, see my previous paper: N.Sparmann, „Tax Challenges of the Digital economy – Does the OECD Model Convention Cover a Special tax on Digital Services?", Lund University, not published, March 2019, p.8-10.
[196] Cf.: Art. 2 of the DST-Directive; European Commission, COM (2018) 148 Final-2018/0073 (CNS), p.10/24.
[197] The first threshold regards the size of the entity and stresses the worldwide annual revenue, which must be exceeded within one calendar year, the second one relates to the actual revenue generated by digital services of the entity within the EU; C.F: Art. 4 para. 1 no.a and no.b of the DST-Directive; European Commission, COM (2018) 148 Final-2018/0073 (CNS), p.25.
[198] European Commission, COM (2018) 148 Final-2018/0073 (CNS), p.21, no.35.
[199] Ibid. No. 198 at p.7-8/17-19 and M. Nieminen "The Scope of the Commission's Digital Tax Proposals", Bulletin for International Taxation (September 2018), Vol. 72 (No.11), p. 668-671.
[200] C.f.: Ibid. No. 198.
[201] D. Hohenwarter/ G.Kofler/G.Mayr/ J.Sinnig, "Qualification of the Digital Service Tax Under Tax Treaties" (2019), INTERTAX (Volume 47 Issue 2) p.142.
[202] OECD "Tax Challenges Arising from Digitalization – Interim Report 2018" (2018), p. 181, no.420.
[203] European Commission, COM (2018) 148 Final-2018/0072 (CNS), p.20, no.27.

the CIT-obligation. There is also no mechanism,[204] which links the DST-burden to CIT-rules or excludes the DST-obligation due to an already existing CIT-obligation.[205] Thus the DST would still be applicable without relation to the domestic CIT-system.[206] In case that the WHT would be drafted after the proposal of the Commission, the tax would in its legal nature not be a tax on income and would rather qualify as a special turnover tax.[207]

5.4.2 Interim Conclusion: Legal Nature of the Tax

As shown, the qualification of the legal nature of the WHT is depending on the actual draft of the tax characteristics. In the scenario where the WHT is drafted after the classical WHT-scheme, the tax meets the qualification of the legal nature of a tax on income and falls under the scope of Art. 2 OECD MC. The DTTs drafted after the OECD MC would be applicable. In case that the WHT is drafted according to the DST-proposal, the WHT does not qualify in its nature as a tax on income and therefore does not fall under the scope of Art. 2 OECD MC. The DTTs drafted after the OECD MC would not be applicable.

5.5 Qualification of Income

In case that the WHT qualifies as a tax on income it needs to be determine which article of the OECD MC is applicable. As shown, the income generated by the SMNE from the provision of digital advertisement services is based of the business activity of this business model. This income does not fit the definition of the types of passive income within the OECD MC. Hence, it is most likely, that this income would fall under the definition of business income.[208] The OECD MC does not include an exhaustive definition of the terms business or business profits.[209] The OECD MC also states that these terms should be interpreted in the light of the domestic law of the involved jurisdictions.[210] Despite the fact that domestic tax systems

[204] E.G.: Content and structure of the Indian Equalization Tax: S.Wagh "The Taxation of Digital Transactions in India: The new Equalization Levy" (2016), Bulletin for International Taxation 2016, Volume 70 (No.9), p.550; also summarized in: R.Ismer/C.Jescheck "The Substantive Scope of Tax Treaties in a Post-BEPS World: Art. 2 OECD MC and the Rise of New Taxes (2017), INTERTAX 2017 Volume 45, Issue 5, p.386.

[205] e.g.: Indian Equalization Tax; the European DST is explicitly applicable regardless if the tax subject is tax resident within the concerning MS or not.

[206] Ibid. No. 201 at p.142.

[207] R.Ismer/C.Jescheck "Taxes on Digital Services and the Substantive Scope of Application of Tax Treaties: Pushing the Boundaries of Article 2 of the OECD Model?" (2018), INTERTAX 2018 Volume 46, Issue 6&7, p.577; Ibid. No.202 at p.146.

[208] L.Burns/R.Krever in „Tax Law Design and Drafting", V. Thuronyi ed. 1998, Vol. 2, Chapter 16, p.2-5.

[209] Art. 3 para. 1 no. h OECD MC only determines that a business includes the performance of professional services as well as activities of an independent character; OECD: "Model Tax Convention on Income and on Capital: Condensed Version 2017 and Commentary" (November 2017), p. 29, Chapter II, Art.3.

[210] OECD: "Model Tax Convention on Income and on Capital: Condensed Version 2017 and Commentary" (November 2017), Commentary acc. Art. 3, p. 97, no 10.2.

differ significantly, the interpretation of the terms based on the domestic meaning of these terms rarely leads to the application of different distributive rules of the OECD MC, but even if the contracting parties apply different distributive rules, Art. 23 OECD MC[211] prevents any double taxation that would result therefrom.[212]

In case, that the jurisdiction of the Market State and the Resident State define the SMNE as a business and the pictured activity as business activity. The received payment would qualify as business income. Therefore Art. 7 OECD MC[213] would be applicable.[214] According to Art. 7 para. 1 OECD MC the business profits of an entity are generally taxed in the Resident State. In the scenario, that the business entity has a PE within the territory of the Market State, the right to tax the income which is directly linked to the PE is allocated to the Market State.

As elaborated, the SMNE is a resident of the Resident State and does not have any physical presence in the Market State and also does not maintain a PE within this territory. In this case the taxation right is allocated to the Resident State based on Art. 7 para. I OECD MC. The taxation right for the Market State based on the implemented WHT is in this way undermined. In this scenario the Market State can again not tax the income of the non-resident SMNE sourced within its jurisdiction. The same result occurs even if the income does not fit any domestic income definition of the contracting states and Art. 21 OECD MC[215] is applicable. This application is also resulting in the allocation of the taxation right to the Resident State.

5.6 Interim Conclusion: Compliance with OECD MC

As shown, whether the is covered by the OECD MC is depending on the way how the characteristics of such tax are actually drafted.[216] In case the WHT does not qualify in its nature as a tax on income the tax does not fall under the Scope of Art. 2 OECD MC. The DTTs are not applicable and the SMNE cannot obtain relief from the double tax burden.[217] In the scenario where the WHT meets the qualification of the legal nature of a tax on income, the tax falls under the Scope of Art. 2 OECD MC. The DTTs are applicable and a relief from the double tax burden for the SMNE can be granted. However, in this scenario, the right to tax the income is allocated to

[211] Ibid. No. 210 at p. 42, Chapter V, Art.23.
[212] A.Rust in „The Meaning of Enterprises, Business, Business Profits under Tax Treaties and EU Law“, G.Maisto ed. 2011, EC and International Tax Law Series, Vol. 7 Chapter 6, p.86, no. 6.2.
[213] Ibid. No. 211 at p. 33-34, Chapter III, Art.7.
[214] A. Turina, „Which Source Taxation for the Digital economy?“, INTERTAX 2018, Vol.46, Issue 6/7, p.512.
[215] Ibid. No. 210 at p. 41, Chapter III, Art.21.
[216] Ibid. No. 214 at p.516.
[217] G.Kofler/J.Sinnig “Equalization Taxes and the EU’s Digital Service Tax” (2019), INTERTAX (Volume 47 Issue 2), p.195.; D. Hohenwarter/ G.Kofler/G.Mayr/ J.Sinnig, “Qualification of the Digital Service Tax Under Tax Treaties” (2019), INTERTAX (Volume 47 Issue 2) p.147.

the Resident State, based to the lack of a physical presence or a PE within the jurisdiction of the Market State. Consequently the Market State cannot tax the part of income of the SMNE which is sourced within its territory.[218] In the latter the whole purpose of the WHT, to establish a right to tax the income of the non-resident SMNE sourced within its territory for the Market State, is completely annulled.

6 Conclusion

6.1 Summary

Based on the analysis above, within an international setting, the WHT-system is generally capable of enabling a possibility for the Market State to protect its domestic tax system and national tax basis, in case that comprehensive domestic CIT-system cannot readily apply. As shown does the implementation of the described WHT on a national level, not interfere with the VAT-system of the EU. Neither does this WHT constitute a discriminatory restriction of the exercise of the fundamental freedoms of establishment or of the free movement of capital and payments. Furthermore, the WHT does not constitutes prohibited state aid pursuant to Art. 107 para.1 TFEU. The WHT is therefore in line with EU-Law. However, as shown, the WHT-system applied to the business model of a SMNE contains several flaws:

First and foremost, the WHT-system only ensures a taxation right for the Market State over the income of the non-resident SMNE sourced in its jurisdiction, in the case that the contractual partner, which is paying the SMNE for the digital advertisement services, is also located within the territory of the Market State. As long as the PMNE is located in another jurisdiction, the tax object to levy the WHT is missing. Even though the SMNE is economically present and creating value in the Market State. In this case, the implementation of such WHT within the jurisdiction of the Market State would not solve the problem of missing taxation rights over the income of the non-resident SMNE for the Market State. Moreover, is the introduced WHT-system also not able to tax the actual value creation via collected user data in the jurisdiction of the Market State. Furthermore, the establishment of such WHT bears also the risk that the actual economic incidence of the WHT would be carried by the PMNE and not by the targeted SMNE.

[218] Application of Art. 7 or Art 21 and 23 OECD MC, OECD: "Model Tax Convention on Income and on Capital: Condensed Version 2017 and Commentary" (November 2017), p. 33 and 41, Chapter III, Art.7 and 21; p.42, Chapter V, Art. 23.

As already elaborated, the enforcement of such WHT could also lead to double taxation problems within cross-border transactions. In case the WHT is drafted as a tax on income, these double taxation issues can be solved by the application of DTTs. In this scenario the application of the DTTs would lead to the allocation of the taxation right to the Resident State, based on the lack of physical presence of the SMNE in the Market State. Here, the purpose of the WHT, to establish a right to tax the income of the non-resident SMNE sourced within its territory for the Market State, is completely annulled. In the situation that the WHT is drafted as a special turnover tax, the DTTs would not be applicable and cannot grant relief from the double taxation burden for the SMNE. It must be noted that such special turnover tax might interfere with the VAT-system of the EU.[219]

In summary the only scenario, where the pictured WHT establishes a taxation right for the Market State on the income of the non-resident SMNE, emerges where the WHT is drafted as a special turnover tax and the PMNE is also located in the Market State. Moreover, the WHT would only ensure the taxation right for the Market State on a mere fraction of the income of the SMNE. In conclusion, the described WHT-scheme levied on the remuneration generated from digital advertisement services received by non-resident SMNE, would be in line with EU-Law and the OECD MC. But only partially solves the current problem of missing taxation rights for the Market State.

6.2 Outlook

By implementing such WHT the Market State only focuses on encountering the financial effects of the digital economy, the untaxed business profits, but not on the underlying taxation problems. The problem of the digital business models is not that a fitting tax for these kind of income is missing. Digital business models are still generating business income and profits, which are generally covered by a CIT-system in the Resident State. In fact, the digital economy just introduced a way of business activity and value creation without any physical presence. This leads in the current international tax system to a lack of taxation for the Market State. Based on the fact, that the current treaty rules still tie taxation rights to the legal concept of a physical presence.[220] As shown is the WHT-system not a mechanism to establish a new concept of physical presence within the Market State. The WHT just constitutes a source taxation for the Market State on certain digital

[219] Analysis whether the DST interferes with the European VAT-System, see my previous paper: N.Sparmann, „Tax Challenges of the Digital economy – Does the OECD Model Convention Cover a Special tax on Digital Services?“, Lund University, not published, March 2019, p.8.

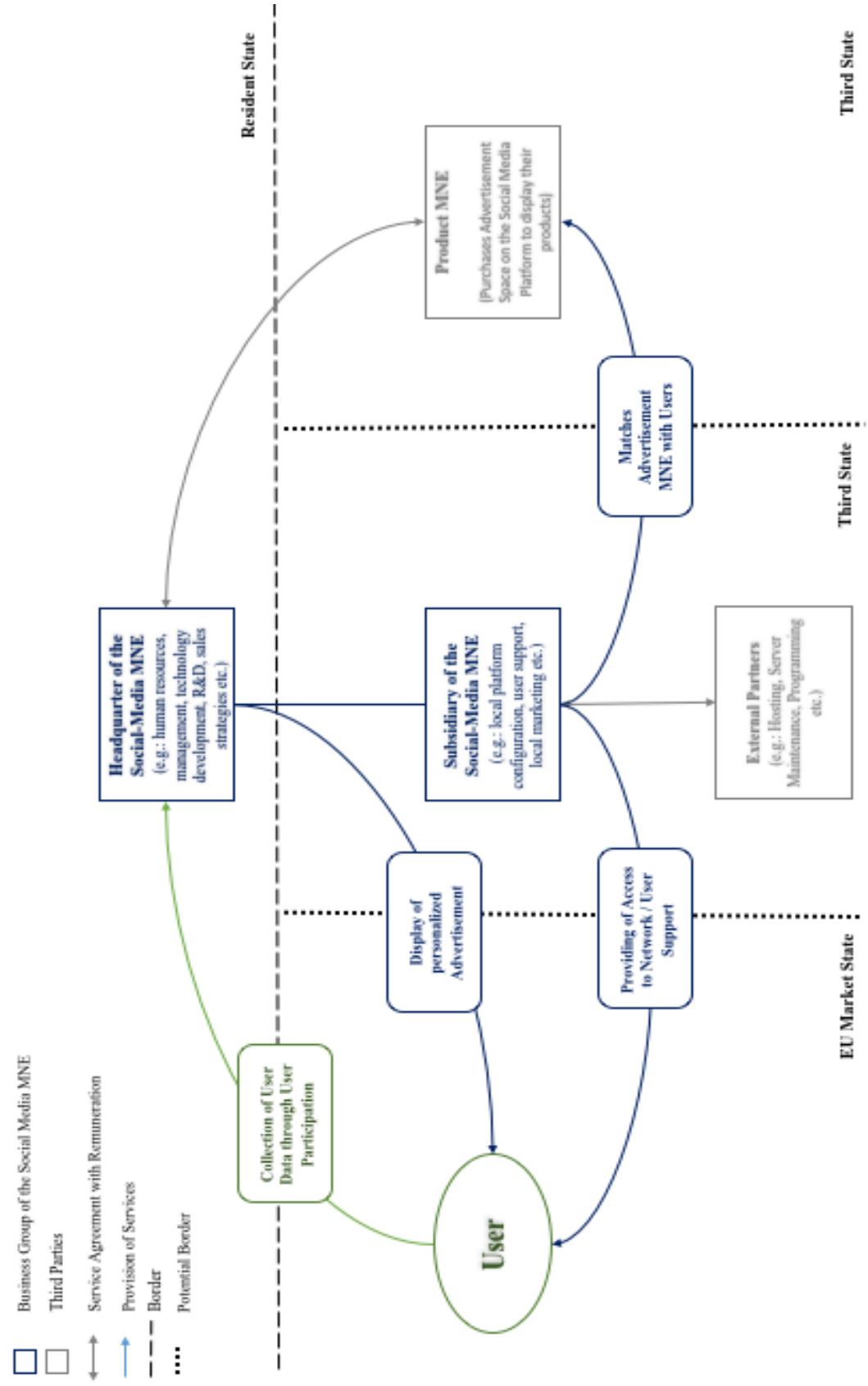
[220] OECD, “Addressing the Tax Challenges of the Digital economy”, BEPS Project 2015, Action 1: Final Report, p. 11, Executive Summary and p. 16.; OECD, “Tax Challenges Arising from Digitalization – Interim Report 2018”, Chapter 2.5.1, p. 51, no.132.

transactions. Consequently, a new WHT on a domestic level is not capable of encountering the underpinning problem of the missing physical presence of SMNEs in the concerned Market State.

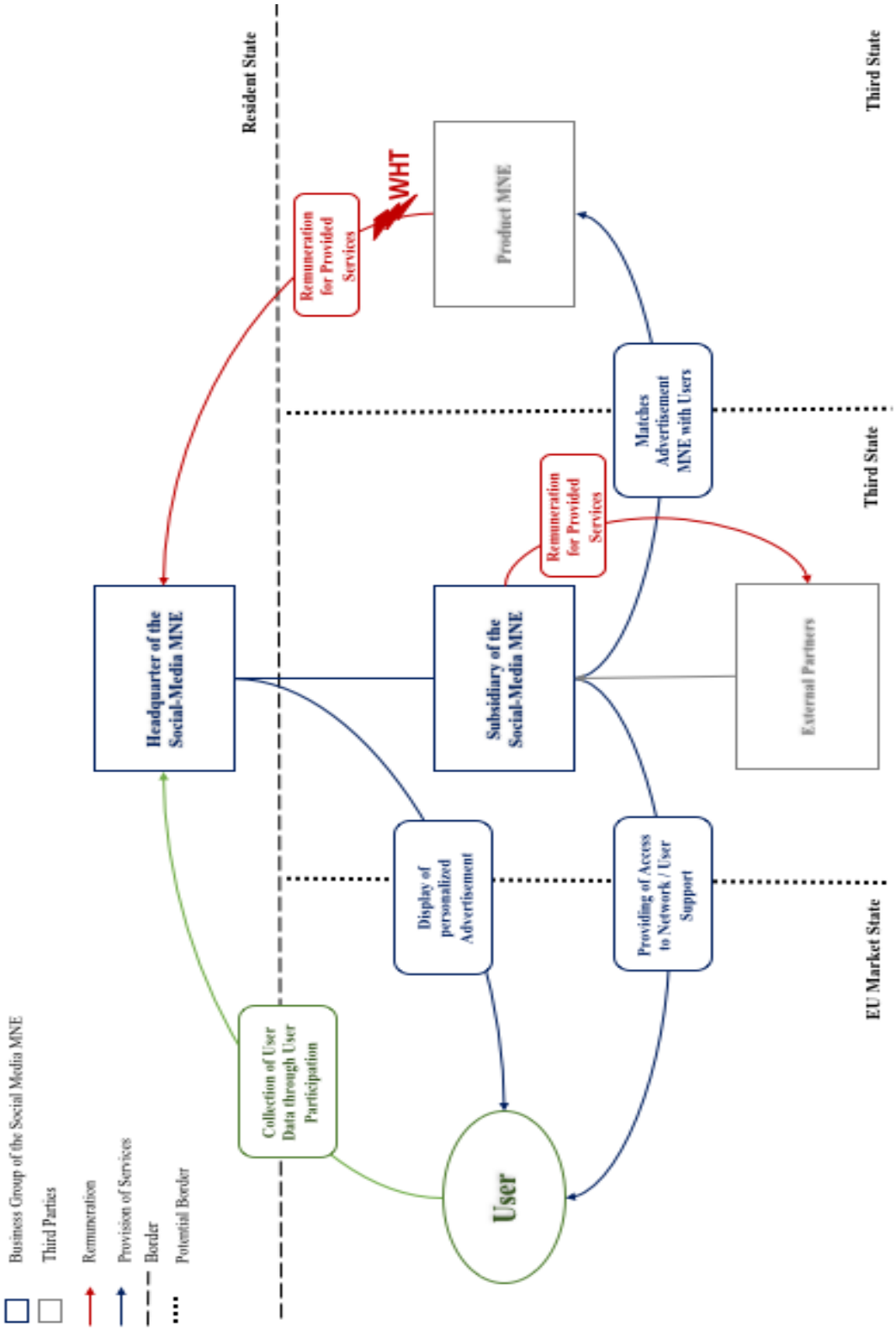
In order to reach the objectives of the OECD and the EU and to provide a sustainable solution for the tax challenges of the digital economy it is more efficient to solve the underlying tax issues on a supranational scale. It remains to be seen, how such multinational solution will reconcile the difficulties regarding the main tax issues of balancing the political interests of Source States and Resident States, the complexity of the new value-creation-chains and the outdated PE-nexus.

7 Appendix

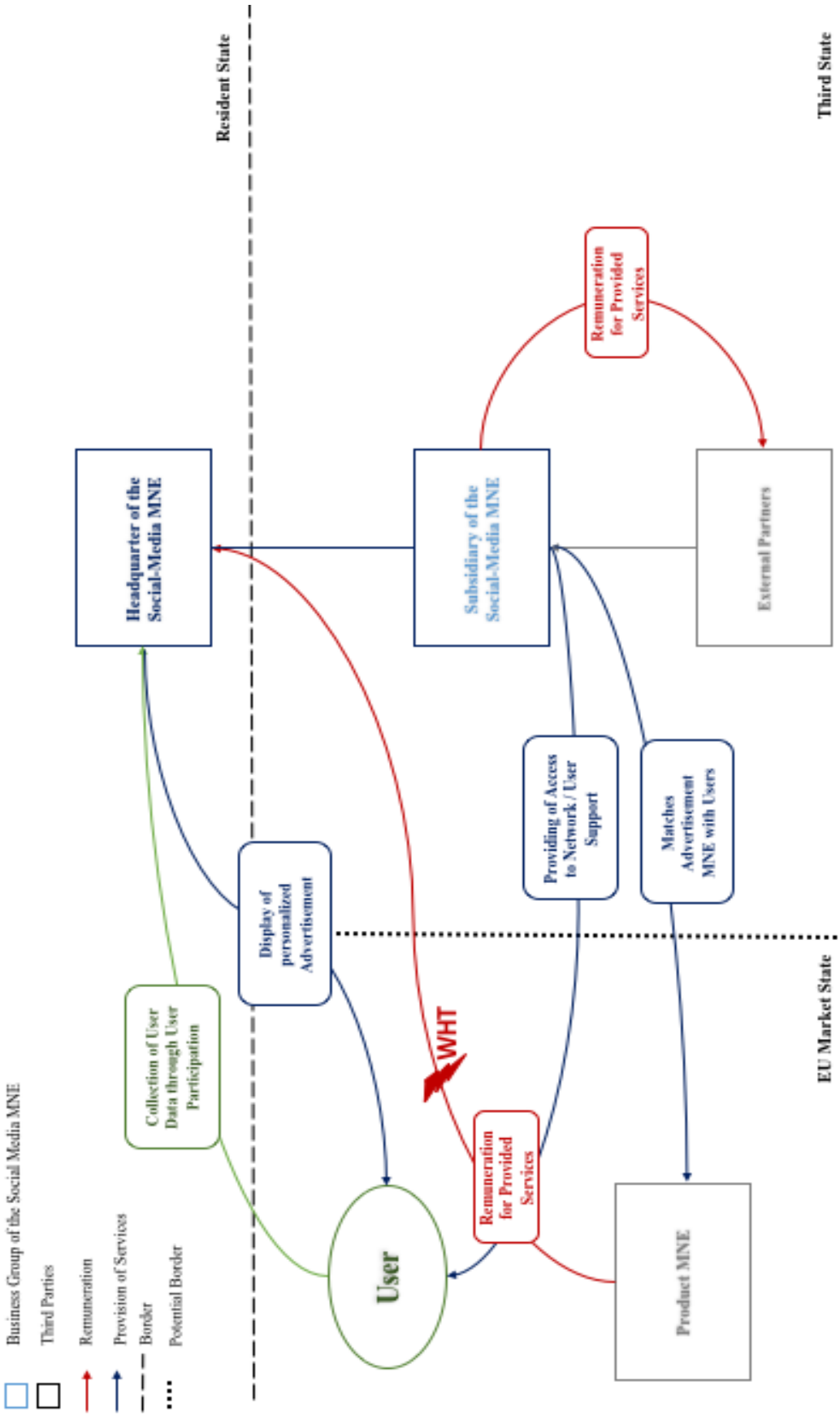
7.1 Graphic I



7.2 Graphic II



7.3 Graphic III



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