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# Tax Challenges Arising from Digitalization: Evaluating the Taxation Models Proposed by the European Commission and the OECD

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**Abstract:** The world has entered a period of deep transition with rapid and phenomenal development of innovations. The rise of the digital economy has dramatically changed the global business environment, creating new challenges for the tax system. Newspapers and magazines are being replaced by the Internet, and trade in material goods – by digital services. The digital economy eliminates the barriers of time, space and distance. The server where the transaction is processed, the location from which the goods or services are supplied and the place of supply of such goods or services are in different jurisdictions, therefore, the question "Where should the transaction be taxed?" is raised. Meanwhile, the digital economy opens up unprecedented opportunities to avoid taxes with the international tax rules which are still "stuck" in 20th-century business concepts, because the companies operating in the digital space do not need factories, stores or other permanent residences to develop their activities. This article aims to evaluate the efforts of the European Union and international standard-setting entities to find a solution for fair taxation of the digital economy. The first part of the article delves into the concept of the digital economy and its essential features with a special emphasis on the role of the digital service user which is unique and more

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complex than the role usually played by the customer. This part also analyses the differences between digital and traditional business. The second part of the study emphasizes the reasons that will lead to the necessity of taxation of the digital economy, discusses the digital services tax applied in certain countries of the European Union and highlights the weakness of the concept of digital establishment in double taxation agreements concluded by the countries. The final part explores the proposals submitted by the European Commission regarding the introduction of a common consolidated corporate tax base and the inclusion of the concept of virtual permanent establishment in the tax system in the context of the digital economy taxation model proposed by international organizations.

## 1. Introduction

Today, we are living through the last known revolution in history, also known as the 4th Industrial Revolution, which is "blurring" the boundaries between physical and digital space. The main pillar of the 4th Industrial Revolution is digitalization, which is characterized by the rapid, deep and widespread penetration of digital technologies into everyday life. In the context of this revolution, the traditional concept of a "one-size-fits-all" economy is being replaced by that of the new economy, also known as the "Digital Economy." The liberal concept of the digital economy is considered to have disrupted the previously rigidly defined traditional business model. The evolutionary processes of modern society are based on digital systems that create a wide range of opportunities. This is giving rise to new digital businesses that do not resemble the traditional business model since they lack physical characteristics, which allows them to operate on a much larger scale, at lower costs and with easier access to consumers.

However, technological progress poses many challenges, especially in the area of tax regulation. In terms of the specifics of corporate tax, the old and universally accepted corporate tax standards are designed for the traditional "bricks and mortar" business model, which means that a company has to have a physical presence in a country in order to be taxed there. The tax rules developed in the early 20th century for traditional physical businesses have begun to mismatch the location of profit taxation and value

creation when applied to new business models. In addition, the characteristics of digitalized businesses, such as the ability to transfer profits from one jurisdiction to another at the touch of a button, or the fact that these business models are the result of consumers being "employed" to interact with each other in the creation of value for these businesses, give them an advantage over traditional business models, leading to the emergence of unfair competition in the global market. It is also important to note that a number of indicators suggest that the tax practices of some multinational digitalized companies have become more aggressive over time, raising serious compliance and fairness issues.

Although matters of direct taxation of corporate income tax are within the competence of national law, it should be noted that, for example, there are currently no specific rules on the taxation of digital businesses in Lithuania. Meanwhile, there is a consensus at both the international and European Union (EU) level that the adoption of a "perfect" international solution will be a long process with no guaranteed success.[1] At the EU level, there has been a proposal to introduce a Common Consolidated Corporate Tax Base ("CCCTB") in the context of digitalization, a proposal by the European Commission on March 21, 2018 to reform the corporate tax rules so that profits are taxed where a company's significant digital activities are located, and a proposal to introduce a temporary tax on income from digital services. The G20 and the Organisation for Economic Co-operation and Development (OECD) have presented a two-pillar framework. In terms of the most recent legislation, it should be noted that, as part of the implementation of one of the pillars, Directive (EU) 2022/2523 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union was adopted on December 14, 2022. However, it is acknowledged that finding a solution at the global level to make the most of globalization through high-quality governance and international rules is a challenging task, especially as taxes are rarely universally acceptable, much less newly introduced ones. Therefore, in view of the widespread digitalization of business in practice and the speed of change in this area, it is appropriate to analyze the proposed model for

[1] Mateusz Kaźmierczak, "EU Proposal on Digital Service Tax in View of EU State Aid Law," *Financial Law Review* 25, no. 1 (2022): 97.

regulating the taxation of digital business without waiting for legal regulation. As such regulation is not yet in place, this topic is of interest not only from an academic point of view but also from a practical one.

The authors acknowledge that digital taxation issues also extend to indirect taxation, but due to the limitation of the object of this publication, this field of taxation will not be addressed.

## 2. The Reasons behind the Need to Tax the Digital Economy

The concept of the digital economy was first articulated by Don Tapscott, who wrote in a 1995 seminal paper that "the Internet and the World Wide Web are enabling a new economy based on human intelligence."[2] It is notable that today there is still no succinct definition of the digital economy, as various economic activities are usually defined.

In a literal discussion of the term digital economy, the English word "digital" in electronics and computing means "encoded in numbers."[3] The terms "digitization" and "digital transformation" are interpreted as processes that operate through digital technologies and have an impact on production processes, the functioning of financial markets, changing economic development patterns and society as a whole.[4] More specifically, from an economic perspective, "digitization" or "digital transformation" is defined as the changes taking place in any part of society through the application of digital technologies. Looking at digital transformation specifically from a business perspective, it is also recognized as a process whereby an increased use of digital technologies in significant processes leads to superior business performance.[5] As stated in the Lithuanian Innovation

2 Łukasz Dawid Dąbrowski and Magdalena Suska, *The European Union Digital Single Market: Europe's Digital Transformation* (London, New York: Routledge, 2022), 1, https://ebookcentral-proquest-com.ezproxy.vdu.lt:2443/lib/vmulib-ebooks/reader.action?docID=6894571.

3 Rimvydas Laužikas, "Digital or Electronic?," *Knygotyra* 51 (2008): 278.

4 Dominik Matt et al., "Industrial Digitisation. A Systematic Literature Review and Research Agenda," *European Management Journal* 41, no. 2–4 (2022): 47–78, https://doi.org/10.1016/j.emj.2022.01.001.

5 Dave Chaffey, David Edmundson-Bird, and Tanya Hemphill, *Digital Business and E-commerce Management* (UK: Pearson, 2019), 23, accessed September 10, 2023, https://books.google.pl/books?id=oYufDwAAQBAJ&printsec=frontcover&hl=pl&source=gbs_ge_summary_r&cad=0#v=onepage&q&f=false.

Ecosystem Review, the use of digital technologies in business is one of the preconditions for developing an innovative business sector.[6]

Given the complexity of the functioning of digitally enabled businesses, however, according to the latest statistics provided by the European Commission, there is a clear advantage of the digital business model compared to the traditional one:

- Digital businesses are growing faster. The largest digitalized companies have an average annual revenue growth of 14%, while the average annual revenue growth of traditional multinational companies ranges between 0.2% and 3%;
- digitized businesses operate with almost no physical presence on the ground. Only 50% of digital multinationals operate abroad compared to 80% of traditional multinationals;
- digital businesses benefit from lower tax rates. On average, traditional businesses pay around 23.2% of tax per year, while digitized businesses pay around 9.5%.[7]

The liberal concept of the digital economy is thus presumed to have disrupted the hitherto rigidly defined traditional business model. Digitally enabled businesses can operate simultaneously in several jurisdictions without a physical presence, however, they are dependent on consumers who contribute to the value creation of the digital business. Nevertheless, these characteristics give digital businesses an advantage in a market that is arguably characterized by high taxes and social and economic inequalities.

As digital services and e-commerce increasingly penetrate the global economy, concerns have been raised about how the tax system will adapt to the rapidly evolving digital economy. As mentioned earlier, there are two types of digital business models – partly digital and exclusively digital – but it should be noted that the former is at least partly suitable for the old tax

[6] Ramunė Juozapaitienė, *Overview of the Lithuanian Innovation Ecosystem* (Vilnius: Government Strategic Analysis Centre, 2021), 13, accessed May 3, 2023, https://osp.stat.gov.lt/services-portlet/pub-edition-file?id=36260.

[7] European Commission, "Fair Taxation for the Digital Economy," 1, accessed May 8, 2023, https://taxation-customs.ec.europa.eu/system/files/2018-03/factsheet_digital_taxation_21032018_en.pdf.

rules, while the exclusively digital business model cannot be adapted to current tax systems. In particular, a number of studies and data have shown that there is an increased disconnect between the place where a company's actual activities are carried out and the place where profits are reported for tax purposes. Genuine business activity is usually identified through such elements as sales, labor, wages and fixed assets.[8] However, the activities of a digital business can be transferred to another jurisdiction at the click of a button. It is often argued that this is also a way of avoiding taxation where taxes are higher. While it has been established that profits are taxed where value is created under the current rules, digitized businesses have started to use schemes to artificially shift profits to economically weak countries with low tax rates or with no tax by exploiting loopholes and inconsistencies in tax rules. This can happen even when legitimate profit-shifting strategies are used.[9] For example, a digitized company sets up its headquarters and digital servers in countries such as Ireland or the Netherlands, where corporations are subject to low tax rates, using the headquarters to provide digital services to the rest of Europe.[10] Google, for example, is just one example of the many digitized companies that have taken advantage of this tax system. For many years, Google has, from its headquarters in Ireland, awarded advertising contracts across Europe so that profits from the contracts were taxed only in Ireland and not in the countries where the ads were placed.[11]

Another important aspect is that taxing a digitalized company does not account for the contribution of consumers to the generation of profits. As mentioned above, the digital economy is dependent on the crucial role of the consumer, but while this is creating increasingly more value for multinational groups of companies operating in the digital economy, it is difficult to measure the benefits that consumers bring. According to

8 OECD, *Addressing Base Erosion and Profit Shifting* (Paris: OECD Publishing, 2013), 20, http://dx.doi.org/10.1787/9789264192744-en.

9 Andrea Darmanin and Kirsten Debono Huskinson, "The Countdown to Pillar One Begins," *ITR*, accessed November 7, 2023, https://www.internationaltaxreview.com/article/2a6aaf-in5m44msd672q68/the-countdown-to-pillar-one-begins.

10 Laurel Wamsley, "France Approves Tax On Big Tech, And U.S. Threatens To Retaliate," *American University Radio*, accessed October 25, 2023, https://perma.cc/H42P-44EZ.

11 Romain Dillet, "Google to Pay $549 Million Fine and $510 Million in Back Taxes in France," *Tech Crunch*, accessed October 25, 2023, https://perma.cc/B24J-AVH7.

the European Commission, new profit attribution methods are needed to measure and define the contribution of consumers to value creation in a company, which would better capture value creation. Current corporate tax rules provide that assessing how much of a company's profits should be attributed to a particular country mainly takes into account the physical location in that country, without reflecting the value created by the user in that jurisdiction.[12] This value is used for targeted advertising and is subsequently used to generate profits, but these profits are not taxed in the country of the user but in the country where, for example, the advertising algorithms were developed. It is therefore argued that, in the context of rapidly changing business models, it is necessary to assess the contribution of data and user involvement to value creation, while at the same time assessing the extent to which data and user involvement contribute to value creation.

### 2.1. Fiscal Jurisdiction over Digital Activities

Tax authorities are currently unsure how to tax income earned on the Internet because the Internet does not easily fit into the existing general international tax framework.[13] Since it was noticed that the determination of fiscal jurisdiction by the residence and source location criteria was no longer as effective in today's economy as compared to traditional business taxation, a new criterion for determining fiscal jurisdiction based on the place of destination was considered as early as the beginning of the 21st century.[14] Proponents of this new criterion argue that in a global world economy where capital moves freely and new economic conditions prevail, both residence and source taxes distort international trade and the movement of capital and business,[15] and that the purpose of establishing a fiscal jurisdiction based on the destination criterion is to reduce or eliminate profit shifting

12 European Commission proposal for a directive laying down rules on the taxation of significant digital activities of undertakings, Brussels, 21 March 2018, 2018/0072 (CNS), 2.

13 Barrett Schaefer, "International Taxation of Electronic Commerce Income: A Proposal to Utilize Software Agents for Source-Based Taxation," *Santa Clara Computer and High-Technology Law Journal* 16, no. 1 (2000): 139, accessed May 10, 2023, https://digitalcommons.law.scu.edu/cgi/viewcontent.cgi?article=1256&context=chtlj.

14 Michael P. Devereux and Rita de la Feria, "Designing and Implementing a Destination-Based Corporate Tax," *Oxford University Centre for Business Taxation WP* 17, no. 7 (2014): 8.

15 Ibid., 2.

and tax competition.[16] The OECD proposes that fiscal jurisdiction could be implemented based on a significant economic nexus. According to this principle, jurisdiction to tax should be allocated according to where the real economic interests of taxpayers lie. Accordingly, natural and legal persons are deemed to have an economic interest where they earn or receive income or where they carry out economic activities.[17]

In order to answer the question of whether States would have jurisdiction to tax businesses based on this criterion, it is argued that the application of this criterion would create a link between what is being taxed and the State imposing the tax. If sales are conducted in a particular State, that State is evidently the source of the revenue: the profits are derived from the sales, and without the sales, there would be no taxable income.

In considering the application of this criterion, the benefit theory mentioned before is also discussed, and it is believed that it could also be applied to this criterion. Similarly to the place-of-source criterion, the benefit theory holds that States should have the right to tax income that is sourced within their territory, as this is the "place of generation," a right that derives from the principle of territoriality enshrined in international law. Furthermore, States should have the right to tax income that originates in their territory, since the States where consumers reside provide them with services that complement the consumption carried out by their population. This creates a win-win situation whereby the State, through its policy of raising wages and contributing to the improvement and development of Internet connectivity, contributes, albeit indirectly, to the promotion of consumption among its population by creating the conditions for the online purchase of goods and services, and, consequently, the businesses receive revenue from these consumers and should therefore pay a proportion of the corporate tax.

In a global economy, it is argued that both residence and source taxation should be abandoned in favor of a new factor linking tax jurisdictions:

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[16] Shafik Hebous and Alexander Klemm, "Destination-Based Taxation: A Promising but Risky Destination," in *Corporate Income Taxes Under Pressure: Why Reform Is Needed and How It Could Be Designed*, ed. Alexander D. Klemm (Washington, DC: International Monetary Fund, 2021), 265.

[17] Elena Neshovska Kjoseva, "Taxation in Era of Globalization and Digitalization: Issues and Challenges on National Tax Sovereignty," *Iustinianus Primus Law Review* (2021): 6.

the location of consumers, which is less mobile than business activity and more difficult to manipulate for tax purposes. It is argued that the State where the consumer of the goods or services provided by the business entity is located would have jurisdiction to tax it for essentially three reasons: (i) sales are the ultimate source of profits and without sales – there would be no taxable income; (ii) it is a "source of income" State and therefore its right to tax would arise even under the principle of territoriality established by international law; and (iii) as a State of residence of the consumers, it is a State that provides services that are complementary to the consumers' consumption (and therefore provides services that indirectly contribute to the production of income).

### 2.2. The Lithuanian Concept of a Permanent Establishment in the Context of Digitization

The legal concept of a permanent establishment sets out the necessary criteria for the link that an economic or commercial activity has with a particular State to be considered sufficient to give rise to a tax liability in that State.[18] However, as Irmantas Rotomskis rightly points out, the possibility of taking business online in recent decades has raised new obstacles to applying the concept of permanent establishment. As has already been shown, in the digital economy, thanks to advances in information technology, activities are carried out via the Internet. Consequently, in the digital economy, a remote link is created between the State and the taxable profits, but this contradicts the concept of a physical permanent establishment, because, in the absence of a physical link, the State in which remote digital activity is carried out has no legal basis to claim taxing rights. It is important to emphasize that the various aspects of corporation tax are exclusively a matter of national law. This means that it is with the country in whose territory the activity is carried out that lies the full competence to tax businesses established (i.e. tax resident) and domiciled in its territory.[19] The Law on Corporate Income Tax of the Republic of Lithuania states that Lithuania has full competence to tax business entities established and having their

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18 Irmantas Rotomskis, "The Significance of the Head Office Institute in Avoiding Double Taxation in Electronic Commerce," *Jurisprudence* (2004): 135–6.

19 See footnote 9: "Issues and Challenges in the Taxation of Digital Business," 102.

permanent establishment in its territory – "The taxable profits of Lithuanian units and permanent establishments shall be taxed at a tax rate of 15 per cent."[20] Article 5(1)(2) of this law also states that certain types of income of a foreign entity shall be taxed at a 10% tax rate when the source of income is in the Republic of Lithuania and the income is not derived from that entity's permanent establishments in the Republic of Lithuania.[21] Article 4 of this law contains an exhaustive list of cases in which this tax also applies to foreign companies, but this list does not include income received by a digitized company. It is therefore important to underline that Lithuanian national law does not currently stipulate specific rules on the taxation of digital businesses, as the Lithuanian Corporate Income Tax Law does not address the taxation of digital domiciles.[22]

Accordingly, against this background, the aspects of double taxation in the context of digitalization should also be highlighted, as a permanent establishment is the most important aspect of the institution of double taxation. For example, the Treaty between the Government of the Republic of Lithuania and the Government of the French Republic on the avoidance of double taxation of income and capital and the prevention of fiscal irregularities states that "[t]he profits of an enterprise of a Contracting State shall be subject to tax only in that State if the enterprise does not engage in commercial and economic activities in the other Contracting State through a permanent establishment situated therein."[23] "For the purposes of this Treaty 'permanent establishment' shall mean a fixed place of business through which the whole or part of the commercial and economic activities of an enterprise are carried on."[24] The exhaustive lists in Article 5(2) to (4) of the said treaty define what is included in and excluded from the notion of permanent establishment, but it is noted that under the treaty, the notion of a traditional permanent establishment does not include the head office

[20] Law on Corporate Income Tax of the Republic of Lithuania, State Gazette No. 110–3992 (2001), Article 5(1)(1).

[21] Ibid., Article 5(1)(2).

[22] Vilnius University Faculty of Law Student Scientific Society, *Spring of Legal Science* (Vilnius: Vilnius University Publishing House, 2020), 112.

[23] Treaty between the Government of the Republic of Lithuania and the Government of the French Republic on the avoidance of double taxation of income and capital and the prevention of fiscal irregularities, State Gazette No. 106–2675 (1997), Article 7(1).

[24] Ibid., Article 5(1).

of an undertaking carrying out digital activities. A similar situation can be observed in the other double taxation treaties that Lithuania has concluded with 58 other countries.

Double taxation is often cited as a major obstacle to unrestricted economic progress. It is clear that the current double taxation treaties between countries are not suitable for taxing digital businesses, as these treaties only tax entities with a traditional permanent establishment. It is therefore considered necessary to revise and supplement the existing double taxation treaties once standards for the taxation of the digital economy have been established.

### 2.3. Digital Service Tax

It is clear that today's rules make it possible for digital businesses to operate without being taxed, generating significant revenues. Despite ongoing negotiations in international law, EU countries, such as Austria, France, Hungary, Italy, Portugal, Poland and Spain, have taken national measures to ensure that all businesses – digital and traditional – pay their fair share of tax, and in view of the real risk that non-taxed digital business profits pose to Member States' tax revenues. In contrast to Lithuania, these countries have introduced in their national legislation a digital services tax, the main objective of which is to ensure the taxation of technology-based multinationals despite their physical absence.

However, when assessing the effectiveness of this digital services tax in taxing the digital economy, it is noted that such unilateral measures by Member States may violate existing tax treaties which provide for the taxation of corporate income without a sufficiently significant physical presence in the country imposing the tax.[25] At the same time, the different rates of this tax, the scope of taxation and the different thresholds for taxing corporate income have given rise to widespread debate, on the grounds that this discriminates against large digitalized companies and is incompatible with the principles of international taxation. For example, following France's introduction of a 3% digital services tax

[25] Katherine E. Karnosh, "The Application of International Tax Treaties to Digital Services Taxes," *Chicago Journal of International Law* 21, no. 2 (2021): 516, accessed May 15, 2023, https://chicagounbound.uchicago.edu/cjil/vol21/iss2/8.

on digital intermediation and advertising services based on consumer data in 2019, the United States of America has launched an investigation into the amount of tax France imposes on US companies. A report by the Office of the United States Trade Representative (the "US Trade Representative") found that France discriminates against major US companies and violates prevailing international tax principles because the taxable income is not linked to physical presence.[26] Meanwhile, the French digital services tax is nicknamed the "GAFA tax," an acronym for the major US companies Google, Apple, Facebook and Amazon.[27] However, this acronym might be misleading, as in France the tax is not only levied on US companies but also other major multinational digitized companies. Although the prospect of retaliation on the part of the US has led France to consider a temporary suspension of the digital services tax to reach a compromise on international digital taxation, the digital services tax is still in force in France today, given that international agreements have not been implemented.

There is no universal agreement regarding digital service tax efficiency. According to a survey, a considerable number of countries have postponed the digital service tax (DST) (for example Belgium, Poland, Hungary, Canada, Czechia, Tunisia, Uganda, Zimbabwe, Brazil, Colombia and Sierra Leone).[28]

> Hungary has had an active DST since July 2017, but the tax rate has been set to 0% since July 2019. Poland, Belgium, Columbia, Brazil and the Czech Republic all proposed a DST, but decided to not adopt it. Tunisia, Uganda, Zimbabwe and Sierra Leone all adopted a DST, but have not implemented it.[29]

In summary, the absence of a proper tax framework for the digital economy is contrary to the legal concept of a permanent establishment and

[26] Congressional Research Service: Informing the legislative debate since 1914, "Section 301 Investigations: Foreign Digital Services Taxes (DSTs)," updated 1 March 2021, 1, accessed May 10, 2024, https://crsreports.congress.gov/product/pdf/IF/IF11564.

[27] "Digital Services Tax in France," Bird & Bird, accessed October 24, 2023, https://www.twobirds.com/en/insights/2019/global/digital-services-tax-in-france.

[28] Sofía Balladares, Mona Barake, and Enea Baselgia, "Digital Service Taxes Kane Borders," June 2023, accessed May 9, 2023, https://www.taxobservatory.eu/www-site/uploads/2023/06/EUTO_Digital-Service-Taxes_June2023.pdf.

[29] Ibid., 28.

creates the conditions for many multinational digitalized corporations to operate without being physically established in the countries from which their profits are derived. At the same time, it encourages the emergence of unfair competition in the market, as digitalized companies that operate across borders and use sophisticated tax avoidance schemes may have a significant advantage over other small or medium-sized enterprises.

## 3. Evaluation of Proposed Models for Taxing the Digital Economy

Due to the need to create a suitable taxation model, with the establishment of the Code of Conduct group in 1997, the EU began to promote the policy of fair tax competition. In the field of corporate taxation, the most important result achieved at the EU level was the Code of Conduct for Business Taxation, which addresses the issues of tax evasion and avoidance, and competition in taxation within the EU and beyond. The Member States have committed themselves at the political intergovernmental level to monitor potentially harmful tax measures of the EU Member States and to correct those tax measures that could be harmful to the tax bases of the Member States.[30]

Corporate income is generally taxed at the national level, noting that the EU has exclusive competence only in the area of indirect taxes such as VAT.[31] Decisions on taxation with direct taxes, such as corporation tax, are the exclusive prerogative of national law. It should be noted that the EU's Consolidated Treaty establishing the European Community does not explicitly provide for legislative competence in direct taxation. However, a systematic interpretation of Article 115 of this treaty, which states that the EU is authorized to adopt directives for the approximation of the laws, regulations and administrative provisions of the Member States directly affecting the common market, suggests that the EU has the right to intervene in the European regulation of corporate tax and, within the limits of its competence, to address, by various means, the issues relating

30 "Code of Conduct Group (Business Taxation)," Council of the European Union, accessed September 4, 2024, https://www.consilium.europa.eu/en/council-eu/preparatory-bodies/code-conduct-group/.

31 Consolidated Treaty establishing the European Community, State Gazette No 2–2 (2002), Article 93.

to the improvement of the functioning of the EU's internal market and the solution of common problems of Member States.[32]

## 3.1. Introducing Rules on the Taxation of Significant Digital Activities of Companies

On March 21, 2018, the European Commission published two legislative proposals: a long-term one to reform corporate tax rules to tax profits where a company has a significant digital presence and a short-term one to introduce a temporary tax on income from digital services. Regarding the first, long-term proposal – a general reform of the EU's corporate tax rules on digital activities – the European Commission points out that this proposal would allow Member States to tax profits earned in their territory even if the company has no physical presence there. The proposal recommends extending the concept of permanent establishment for corporate tax purposes in each Member State to include the definition of a significant digital establishment. The proposal seeks to set quantitative thresholds relating to the taxable enterprise's revenue, the number of users and the number of business contracts concluded.

While in this proposal the location of consumers for corporate tax purposes, and not, for example, the origin of the payment, is the key to determining the place of taxation, measuring the number of consumers over a given fiscal period leaves unclear how long consumers should be in the home jurisdiction.[33] It is also clear that the proposal does not take into account the consumer's place of residence. For example, if a consumer has to travel for personal or professional reasons to a particular country, the same consumer may be counted more than once under the proposed criteria. In addition, the same user may access the same website via different platforms, which would presumably further complicate the application of the criteria set by the significant digital presence. It can therefore be understood that the criteria are linked to the presence of a large user base in the jurisdiction, but this does not seem to take into account the differences

[32] See footnote 9: "Issues and Challenges in the Taxation of Digital Business," 108.

[33] Marina Barata, "A Consensus Solution for the Taxation of the Digital Economy," *UNIO – EU Law Journal* 7, no. 1 (2021), 131, accessed May 10, 2023, https://revistas.uminho.pt/index.php/unio/article/view/3576/3631.

in the market between the geography, size of the economy or population of the different EU Member States.

Another important point is that in the preamble to the proposal, the European Commission states that the criteria should apply to different types of business models.[34] However, according to Marina Barata, digital business models are very heterogeneous – some may have a very large consumer base and others a smaller one, but may still have a significant consumer contribution.[35] Thus, the limit on the number of users raises doubts about whether this is actually about the value created by users, as not all users contribute equally to digital business, and different digital models allow for different levels of user involvement.

It is also noted that the preamble to the proposal also adds that it is essential that each of the thresholds for the criteria for a significant digital establishment is sufficiently high to safely exclude small entities where the profits attributable to the digital establishment do not even cover the cost of the tax liability of the permanent establishment, i.e. to ensure the proportionality of the measure in the application of these three alternative thresholds.[36] It seems reasonable to believe that this would only tax large digitalized companies located in developed countries while leaving out small and medium-sized companies located in developing countries. This raises the question of how such regulation would be coped with by start-ups which would not be able to achieve the objectives of this initiative.

## 4. Conclusions

1. Businesses enabled by advanced information technologies operate simultaneously in several jurisdictions, without a physical presence, and are dependent on consumers who contribute to the value creation of digital business. These characteristics enable activities to be carried out

34 European Commission Proposal for a Directive laying down rules concerning the taxation of significant digital activities of undertakings, Brussels, 21 March 2018, COM(2018) 147 final 2018/0072 (CNS), https://eur-lex.europa.eu/resource.html?uri=cellar:3d33c84c-327b-11e8-b5fe-01aa75ed71a1.0011.02/DOC_1&format=PDF.

35 See footnote 33: "A Consensus Solution for the Taxation of the Digital Economy," 130.

36 See footnote 34: European Commission proposal for a Directive laying down rules on the taxation of significant digital activities of undertakings.

on a much larger scale and over greater distances without a physical presence, which results in digitized businesses growing much faster than the economy as a whole, and in the fact that they tend to pay less tax than other traditional, physically established businesses.

2. The current tax system is based on the legal concept of a permanent establishment – a company has to be physically present in a country to be taxed there – but this does not cover digital business models, because as the economy becomes increasingly digitalized, many multinational companies headquartered in a single country profit from services provided to consumers in other countries. This contradicts the concept of permanent establishment, does not ensure the functioning of double taxation and allows for aggressive tax policies that create an unfair and uncompetitive economic environment.
3. The process of harmonizing corporate income tax in the EU is chaotic. The European Commission's proposal to introduce a Common Consolidated Corporate Tax Base (CCCTB) does not specify the characteristics of digital businesses, and the European Commission's proposals of 21 March 2018 have been particularly criticized for proposing unclear formulas for calculating the contribution generated by users and for setting too high a quantitative target. It is argued that this may lead to qualification issues in distinguishing between digital businesses that fall within the scope of regulation and those which do not and that the quantitative criteria set may be considered arbitrary.

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