From Ottawa to Lausanne: Much Done but More to Do?

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Abstract: This mini-track on e-Tax and e-Revenue coincides with the 10th anniversary of the landmark Ottawa meeting. Most concerns then related to widespread tax base erosion due, inter alia, to the anonymity of Internet activity, the high mobility of e-business and the attraction of tax havens. Most, certainly not all, of these concerns have been allayed since but the debate as to what constitutes a Permanent Establishment (PE), and the level of attributable profits to such a PE, is ongoing. Using a case study scenario approach, I consider the tax issues which a typical MNC would encounter in seeking to reengineer its global activities. The conclusion highlights the need for more specific guidance in this area.

Keywords: e-business, e-commerce, e-tax, e-revenue, Permanent Establishment (PE), international tax strategy, transfer pricing

1. Introduction

This paper provides a review of the manner in which tax authorities and taxpayers have coped with the evolution of e-commerce from a direct tax perspective. This mini track on e-tax and e-revenue coincides with the 10th anniversary of the landmark ministerial meeting held in Ottawa in late 1998. I review here the manner in which regulatory provisions have evolved since 1998, both internationally and from an Irish tax perspective. Ireland has become an attractive location for foreign direct investment (FDI) with the advent of the 12.5% corporation tax rate since 2002 and its domestic tax legislation has matured to bring it in line with its principal trading partners. Its domestic tax laws make Ireland an ideal location as a hub for an e-commerce location.

Multinational corporations (MNCs) have been forced to consider key tax issues in considering their global tax planning strategies. I review their approaches and the issues which they have encountered from a direct tax perspective. Ten years ago the biggest concerns from a tax authority perspective were concerns about widespread tax base erosion due, *inter alia*, to the anonymity of Internet activity, the high mobility of e-business and the attraction of tax havens. Most, certainly not all, of these concerns have been allayed in OECD and EU deliberations and by individual country tax authority guidance notes. Most business models utilised in e-commerce allow taxpayers much greater flexibility to transfer business functions from one entity or location to another compared to traditional bricks and mortar business structures. In fact, the flexibility inherent in many of these new operating structures is often one of the main factors that render these business models commercially viable and competitive in comparison to traditional structures. MNCs continue to redesign their operations to adapt to the new efficiencies offered by the medium.

Whilst the comments made by the OECD to date have been very helpful, the debate as to what constitutes a Permanent Establishment (PE) and the level of attributable profits to such a PE will continue until more specific guidance, and/or regulation, is provided. The absence of case law precedents for e-Commence in this area adds to the uncertainty. Using a case study scenario approach, I consider here the tax issues which a typical MNC would encounter in seeking to reengineer its global activities. Ireland features as part of the overall strategy for very good tax reasons. The conclusion to the scenario presented highlights the need for more specific guidance in these areas.

2. Case scenario – Background facts

Global Software Engineering Corporation (GSECorp) is a publicly quoted US corporation. It develops and sells non-customised software packages to business and personal customers. Its products are distributed worldwide through the Internet. Up to now it has sold directly to both business and private customers in Europe via a server based in Ireland. The software which it has sold to date requires significant technological improvement to increase GSECorp's market share. This will require significant capital investment in research and development (R&D) programmes.

GSECorp is profitable; however its combined US federal-state tax rate is 34% which is impacting on its earnings per share (EPS). GSECorp is exploring structures to earn future profits in Ireland and

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defer US tax until the profits are repatriated to the US. It is conscious that it needs to consider such a strategy to manage its worldwide effective tax rate, to bring it in line with its competitors in an increasingly competitive sector. GSECorp projects that its profits from European sales could reach 60% of total worldwide profits within two to three years and it wishes to fund its international expansion, preferably with pre-US tax dollars. Its extant and proposed models are now described.

In its existing business model GSECorp distributes its software (business software and computer games applications) to both business and private individual customers in the US and Europe using the medium of the Internet as its primary sales application. It now proposes a radical shift in strategy in a new model which proposes transferring part of its existing intellectual property rights in its software programmes to a newly incorporated subsidiary in Ireland (IRCo) under a cost sharing agreement. Under the agreement the US parent and Irish subsidiary are each treated as the economic owner of any intangible property developed and are each entitled to receive the income derived from the intangible in their respective markets. This remodelling would involve the following steps:

- It sets up a new Irish company (IRCo)
- IRCo and GSECorp enter into a Cost Sharing Arrangement (CSA) whereby existing intangibles would be transferred from the US to Ireland. This would be subject to a detailed transfer pricing study.
- Following the effective date of the CSA, IRCo will become the co- owner and co-developer of any new software developed. Future development activities in the short term may continue at the US facilities, which IRCo will reimburse under the CSA.
- IRCo will own the server through which all European sales will be processed.
- IRCo will act as the master distributor of the software and maintain a call centre for its after sales service.
- IRCo will provide warehousing support and inventory maintenance support for non US operations.
- IRCo will undertake and fund significant R&D activity in Ireland.
- IRCo will set up distribution companies in Europe to act as either commissionaires or limited risk distributors so as to ensure that the lion's share of the European profits are derived by IRCo. Ireland offers a favourable tax regime for MNCs wishing to locate an intermediate holding company positioned between the European subsidiaries and the ultimate US parent.
- The US parent will need to consider its Sub part F position in relation to its European operations to ensure that the benefits of tax deferral are maintained. Sub Part F is the US form of Controlled Foreign Corporation legislation, which subject to US taxes on a current basis the income of certain foreign subsidiaries.

Issues to be considered

The issues facing GSECorp, based on this scenario are as follows:-

- Will a server located in Ireland constitute a permanent establishment (PE)?
- Planning the use of foreign tax credits.
- US tax implications of any outbound transfer of intangibles from the US.
- Addressing any withholding tax on licenses and service fee payments between group members.
- Avoiding complexities and costs associated with "buy-in" cost sharing payments.
- Establishing and supporting appropriate transfer pricing.
- Implications of Subpart F.

It is key that the tax planning process commences prior to any reengineering of the company's business model.

EXISTING MODEL: Does the US Company have a PE in Ireland? Under general international tax provisions, the extent to which trading income may be regarded as taxable in any given jurisdiction will depend on whether that jurisdiction applies the *residence* or the *source* principle. The two concepts are not mutually exclusive and in practice, most taxing authorities apply some form of hybrid

of the two principles. Rules such as these inevitably lead to double taxation of income where companies operate in an international environment. Accordingly, such rules are modified by the inclusion of a PE clause in bilateral double taxation agreements which is aimed at limiting the taxability of income of non-residents. The term PE is a defined term in each bilateral tax treaty and generally consists of a "fixed place of business through which the business of an enterprise is wholly or partly carried on" (OECD Model Tax Convention, Article 5-1: OECD, 2005a)). Where a PE does *not* exist, bilateral agreements generally provide that the business profits of a non-resident *cannot* be taxed in the source country .

The concept of PE can be traced back to the late 1800's when European countries commenced the process of negotiating bilateral tax treaties to govern the tax treatment of cross border economic activity. The early versions of tax treaties emerged in the post World War 1 era, when countries were concerned that the potential to suffer double taxation in cross border activity was inhibiting an economic revival after the war. Skaar (1991) notes that the principal has undergone a significant dilution during the late 20th century to cater for the evolving commercial practices. The concept of PE is focused on a physical presence which in the world of e-commerce, where the *physical nexus* is not as readily apparent, creates difficulties. A basic tenet in taxation law is that there is a broad distinction between trading *with* a country and trading *within* a country – the latter giving rise to potential foreign tax issues. The distinction was expressed by Lord Herschel as follows:-

> *Many merchants and manufacturers export their goods to all parts of the world, yet I do not suppose any one would dream of saying that they exercise or carry out their trade in every country in which their goods find customers. … If all that a merchant does in any particular country is to solicit orders, I do not think that he can reasonably be said to exercise or carry on his trade in that country [Grainger & Son v Gough, 1896, p. 467].*

In determining whether a taxpayer is carrying on a trade within a country and thereby potentially having a PE there, one would *inter alia* look to the following factors:-

- Place where the contract of sale or service is executed.
- Place where the sale takes place (i.e. title in the goods sold passes to the buyer) or service is rendered.
- Place where the sales invoice is raised.
- Place where the establishment is located to which the income can be attributed.
- Place where the sale proceeds are collected.
- Place where the cost of operations is incurred/charged.

The Internet provides an environment where automated functions are able to undertake a significant level of business processes in a jurisdiction with little or no physical activity or participation in the economic life or use of particular infrastructure. The concept of PE is challenged.

Commentators have argued in favour of taxing rights being based on *sales* in a jurisdiction. Vogel (1998) argues that exertion of tax jurisdiction over significant sales into a source country can be justified simply on the basis that the source country market presented opportunities for the profits to be generated in the first place. McLure (2000) similarly argues the point on the basis that a source country government provides the means to access the market by providing suitable infrastructure facilities. At a more extreme level, Cordell (1997) argued in favour of a *bit tax* or a *cyber tax* believing that if the new wealth of nations derived from networks, that logically it would be appropriate to develop a turnover tax based on digital traffic. His logic, however sound, was discredited by the OECD and major taxing authorities on the basis that it would not be consistent with the system of taxation applied to conventional trade. Article 5 of the OECD (2005a) model convention defines a PE as 'a fixed place of business through which the business of an enterprise is wholly or partly carried on, or a dependent agent who has, and habitually exercises, authority to conclude contracts in the name of a non-resident.'

Tax treaties typically exclude activities that are regarded as *merely preparatory or auxiliary in nature* such as the maintenance of a warehouse to store goods or an office used solely for the purpose of advertising or supply of information (OECD, 2005a: Article 5-4). Early suggestions that a website may constitute either a fixed place of business or a dependent agent were countered by arguments that business over the Internet can be reduced to the concept of communicating and that in the absence

of a substantial amount of accompanying capital and human resources, a website would not constitute a PE (O'Halloran, 2005). Lubbock and Krosch (2000) argue that a website does not by itself constitute a PE on the basis that it is similar to a medium for the display of goods or an advertisement. They argued that this is the case even where the website facilitates the placing and accepting of orders. However, it is clear that this view should only be interpreted narrowly. A situation where a website or server goes beyond merely soliciting business and has capabilities of processing orders may indeed constitute a PE. SMART (System for Managing Agents in Real Time) agents may facilitate the downloading of order processing programs from a supplier's website, the acceptance and processing of any order received, and the collection and digitised deposit of fees. In these circumstances, the SMART agent may be regarded as carrying out the business and as such may constitute a PE (OECD, 2005a, para. 42-9). Conversely, Lambooji (2002) has challenged this interpretation – in his view a server is just a means of delivering product and therefore has only an *auxiliary* function.

Early consideration of the taxing of unmanned equipment being taxable in a *source* country was undertaken in the context of gaming and vending machines. OECD commentary suggests that the determining factor "depends on whether or not the enterprise carries on a business activity besides the initial setting up of the machines" (2005a, Art. 5 para.10). The OECD (2005b) considered whether or not the treaty rules (with regard to residence and source) for taxing business profits are appropriate for e-commerce activities and concluded that no fundamental changes to the existing rules were necessary. The clarifications offered by the OECD have been instrumental in resolving some, if not all, of the uncertainty. The OECD's final conclusions were published by the Committee on Fiscal Affairs in 2000 and were incorporated into the 2003 update to the Commentary on the OECD Model Tax Convention. Their main conclusions are now summarised.

Conclusion 1 - A website cannot, in itself, constitute a PE The place of business concept is a physical concept. The OECD suggests that an Internet web site, which is a combination of software and electronic data, does not in itself constitute tangible property. It therefore does not have a physical place or location that can constitute a *place of business* as there is no *facility* such *as premises or, in certain instances, machinery or equipment* as far as the software and data constituting that web site is concerned. In other words, the website merely facilitates the conduct of electronic commerce. On the other hand, the server on which the web site is stored and through which it is accessible is a piece of equipment having a physical location and such a location may thus constitute a *fixed place of business* of the enterprise (OECD 2005a, para. 42.2, p. 103)

Conclusion 2 - Website hosting arrangements typically do not result in a PE for the enterprise that carries on business through the hosted website. Fees paid to the ISP under such arrangements are generally based on the amount of disk space used to store the software and data required by the web site. As these contracts typically do not result in the server and its location being at the disposal of the enterprise, even if the enterprise has been able to determine that its web site should be hosted on a particular server at a particular location, the OECD suggests that the enterprise does not have a place of business at that location since the web site is not tangible. However, if the enterprise carrying on business through a web site has the server at its own disposal, for example it owns (or leases) and operates the server on which the web site is stored and used, the place where that server is located could constitute a permanent establishment of the enterprise if the other requirements of the Article are met. The functions performed at that place must be significant and an essential or core part of the enterprise's business activities to give rise to a PE.

Conclusion 3 - Except in very unusual circumstances, an ISP will not constitute a PE for the enterprises to which it provides services A web server is only at the disposal of the enterprise if that enterprise sets up its own web server (i.e. if it owns or has a right of use through for instance a rental or lease agreement relating to a specific server). This criterion assumes that there is a specific identifiable physical asset, which is controlled by the enterprise (locally or from abroad). On this basis, a web site ran by a web hosting service provider on its systems does normally not create a PE, because there are no specific identifiable physical assets put at the disposal of the enterprise. In reality, web hosting contracts do not give the website owner any control over the technical assets on which the web site is hosted. The majority of the businesses that engage in e-commerce activities tend to outsource the web site hosting. The servers of the host are then *not at their disposal*, so that the issue of a PE does not then arise.

Conclusion 4 - A place where computer equipment, such as a server, is located may in certain circumstances constitute a PE. A server is considered to be a device upon which e-commerce applications may be sited or operated from, which allows e-commerce to take place and would usually include the computer hardware and its operating and basic application software. The OECD highlight that in the case of a server, what is relevant is not the possibility of the server being moved, but whether it is in fact moved. In order to constitute a fixed place of business, the commentary states that a server will need to be located at a certain place for a sufficient period of time so as to become *fixed*. The commentary does *not* however stipulate or provide guidelines as to what might be regarded as a 'sufficient' period of time. The second issue considered is whether the business of an enterprise could be regarded as being wholly or partly carried on at a location where the enterprise has equipment (in particular a server) at its disposal. The OECD commentary leaves it open to different tax jurisdictions to determine what might be regarded as a PE. The only guidance provided is whether by utilising such equipment the enterprise has facilities at its disposal where business functions of the enterprise are performed.

Further, the commentary specifies that there is no requirement that the facility is actually manned to constitute a PE. It adds that "this conclusion applies to electronic commerce to the same extent that it applies with respect to other activities in which equipment operates automatically". This appears to be a direct reference to the decision in the case of an unmanned pipeline in Germany (undisclosed plaintiff). In this case, the Federal Tax Court in Germany [Betriebs – Berater, 1996] held that the requirements for the existence of a PE are fulfilled in the case of an unmanned pipeline used for the transport of crude oil. The pipeline was owned by a Dutch corporation, running between two points in Germany and all maintenance and repairs were carried out by independent contractors in Germany. This decision was upheld despite the fact that the transport of crude oil through the pipeline was not brought about by employees, but by automatic control equipment located in another jurisdiction.

Opponents of the German case have drawn on the logic applied in the Berkholz case [Berkholz v Finanzant Hamburg – Mitta – Altstadt c-168/84]. In this case, the taxpayer installed gaming machines on board sea ferries operating between Germany and Denmark. Berkholz argued that their services were supplied from a fixed establishment on board the ships and as such fell outside the charge of VAT as the services were supplied in international waters. The ECJ overruled this argument stating that an establishment must contain a permanent presence of human and technical resources necessary to supply the service. In the end, the logic applied by the German pipeline case was adopted in the OECD commentary. The key is whether the presence satisfies a *core function* of the business, over and beyond that which would be regarded as *auxiliary*.

Conclusion 5 - The functions performed where the server is located must go beyond what is "preparatory or auxiliary" Under the model tax convention activities that are merely preparatory or auxiliary in nature are not regarded as giving rise to a PE (OECD 2005a, article 5-4e). One has to examine on a case-by-case basis having regard to the various functions performed by the enterprise through that equipment. The commentary provides examples of activities which would generally be regarded as preparatory or auxiliary including:- activities which merely provide a communications link – much like a telephone line – between suppliers and customers; advertising of goods or services; relaying information through a mirror server for security and efficiency purposes; gathering market data for the enterprise; and, supplying information.

The key issues to consider are :-

- Do the above type of functions form an essential and significant part of the business activity of the enterprise as a whole?
- Are other core functions of the enterprise carried on through the computer equipment, such that the activities as a whole would no longer be regarded as auxiliary in nature ?

If the response to either or both of the above are positive, and provided the equipment utilised (e.g. fixed server) constituted a fixed place of business of the enterprise, there is a PE. What can be regarded as constituting the core functions of a particular enterprise clearly depends on the nature of the business carried on by that enterprise. For example, the commentary stipulates that in the case of an ISP, whose business is that of operating their own servers for the purpose of hosting web sites or other applications for other enterprises, these services are an essential part of their commercial activity and cannot be considered preparatory or auxiliary.

The position is fundamentally different, however, for an actual enterprise that carries on the business of selling products through the Internet. In that case, the enterprise is not in the business of operating servers and the mere fact that it may do so at a given location may not be enough to conclude that activities performed at that location are more than preparatory and auxiliary. What needs to be done in such a case is to examine the nature of the activities performed at that location in the context of the overall business carried on by the enterprise. It is a relative question how a specific part of a business relates to the business as a whole – there is a need to clearly define the business as a whole and then decide the extent to which the presence satisfies (beyond mere auxiliary) a function(s) of the business. If these activities are merely preparatory or auxiliary to the business of selling products on the Internet (for example, the location is used to operate a server that hosts a web site which, as is often the case, is used exclusively for advertising, displaying a catalogue of products or providing information to potential customers), the auxiliary exclusion will apply and the location will *not* constitute a PE. If, however, the typical functions related to a sale are performed at that location (for example, the conclusion of the contract with the customer, the processing of the payment and the delivery of the products are performed automatically through the equipment located there), these activities cannot be considered to be merely preparatory or auxiliary.If the function is merely a post box, where customers can simply order goods on the web rather than sending in an order form or phoning a sales person, it is clear that the web site is an alternative means of communication and therefore represents an 'auxiliary' function. Whilst the functionality may be more sophisticated and user friendly, and may result in additional business arising, it is still satisfying an auxiliary function in lieu of the conventional catalogue or order form. Even if the customer buys digitised product stored on the local server, the storage function on the web server remains a storage function and therefore auxiliary to the selling of digitised goods.

As ICT develops enabling companies to have virtual existences, the distinction between 'core' and 'auxiliary' activities will become ever more difficult to distinguish. It is complex enough in the physical world. Some jurisdictions have been critical of the uncertainty arising from the requirement that the matter should be considered on a case by case basis and have proposed that the OECD should have been more forthright in their views and should have simply concluded that a server cannot, by itself, constitute a permanent establishment. The Inland Revenue in the United Kingdom has taken the view that in no circumstances do servers, by themselves or together with websites, constitute permanent establishments. Since the 2000 clarifications were incorporated into the 2003 update of the Commentary on the OECD Model Tax Convention, representatives of the business community have requested that some widely-accepted interpretations of the PE concept be expressly included in the Commentary.A study by the OECD (2005b), concluded that there is no actual evidence, contrary to earlier predictions, that the communications efficiencies of the Internet have caused any significant decrease to the tax revenues of capital importing countries. The report did not find in favour of any significant changes to the model tax convention definition of PE or its commentary save for some additional clarification as to what might be regarded as 'preparatory or auxiliary' functions and thus falling outside the scope of a PE.

3. Transfer pricing and profit – Back to GSECorp

In terms of transfer pricing and profit allocation, if a PE exists in the foreign location, then in determining what would be regarded as a proper allocation of profit to a PE will depend primarily on identifying the 'functions' carried out in the source country, the assets located in the source country creating the profits, and the risks that the local enterprise carries. For on line services, the value normally lies in the software rather than the hardware. In most cases therefore, it is likely that a profit margin based on what a third party distributor would achieve should be justifiable. If the local entity has additional functions, assets and risks housed in the local enterprise then a much higher level of profit can be justified. This may present an opportunity for GSECorp to explore the possibility of transferring such assets/ liabilities to a low tax jurisdiction, such as Ireland, as part of its restructuring.
Prior to restructuring, GSECorp used a server owned by an independent third party ISP. Based on the above commentary, the categorisation of its activities in Europe from a direct tax perspective depends on whether the server and its associated functions could be regarded as a PE. In determining whether the server would be regarded as PE and the extent to which it earns profits would be influenced by the following:-

- If the server is solely owned or leased by GSECorp and has been located in Ireland for a reasonable period of time, then this would point to a potential PE issue.

- If the server has the capability to undertake the functions of business (negotiating and concluding sales contracts), this would suggest a PE.
- The level of profit is arguably that which a third party distributor would earn for distributing the particular product in question.

The OECD business profits Technical Advisory Group (TAG) concludes that where the PE consists only of a server or servers hosting one or more web sites through which transactions take place, whether, on a proper analysis, the PE functions as a contract service provider or an independent service provider, the level of profit attributable to it is likely to be relatively low, subject to the potential need to reward the PE's use of *e-commerce marketing intangibles* and the assumption of credit and technology risks. The same is true where personnel are present in the PE but the hardware and software in use were not created by the PE. In the situation where it is assumed that development and construction of hardware and software assets have been undertaken by personnel in the PE, the TAG concludes that a higher profit level will be attributable to the PE commensurate with its creation and economic ownership of assets and assumption of associated risks.

Why restructure the business model? Regardless of whether GSECorp has a PE in Europe, given its expansion plans for Europe where it projects in excess of 60% of its profits will be created in the future, it should consider remodelling such that this proportion of its entire profit is subject to a lesser rate of corporation tax than currently applying in the US. Based on its existing model, even if it has a PE in Ireland only a modest level of profit would be subject to Irish tax at 12.5% and taxed currently under the existing structure in the US without the benefit of tax deferral (The Irish Revenue has confirmed that it does not foresee the mere presence in Ireland of a server of a foreign e-tailer constituting an Irish PE or branch of the foreign e-tailer). Even if the existing ISP arrangement created a PE, it is questionable whether any income of GSECorp could be subject to Irish tax as profit attributable to the PE under treaty rules. Under the *separate enterprise principle*, the profit attributed to a PE should be the profit it would have earned as a separate entity on an arm's length basis. The ISP will already be receiving arm's length compensation for its services from the e-commerce enterprise. If PE profit is determined on an arm's length basis, no additional profit should be subject to tax as profit attributable to a PE.

What GSECorp now needs to achieve is a situation where a newly created IRCo can justifiably earn a significantly higher level of profits and for the group as a whole to enjoy the benefit of a deferral of US taxes. Even if ultimately profits will be subject to US taxes, if it is possible to defer the payment of US taxes GSECorp will be empowered to utilise a greater level of pre US tax profits for expansion purposes into other markets and indeed to fund its additional R&D requirements in Ireland. In practice, from a transfer pricing perspective, it is better to operate in Ireland as a subsidiary rather than a branch. A subsidiary gives greater certainty because:

- the functions and risks of the server subsidiary, which drive the transfer pricing results, can largely be defined by contractual terms structured by the two parties; and
- the transfer pricing rules are generally better developed and more consistent from country to country in relation to separate legal entities than the rules or practices that apply to the taxation of PEs.

Since the announcement of the Irish 12.5% tax rate on trading profits, Ireland has featured on the international radar screen as an attractive location for overseas operations, including e-commerce operations. In contrast to the tax rate of 10%, which applied only to manufacturing and certain financial services operations, the 12.5% tax rate applies to all trading profit from 2003 onwards regardless of the industry sector (with certain minor exceptions) in which the profit is generated .The availability of the 12.5% rate makes Ireland a competitive location for new start-ups in Europe or the relocation of existing operations, provided any tax costs associated with relocation can be avoided.Prior to restructuring, regardless of whether GSECorp had a PE in Europe, all its profits were subject to a global effective tax rate of 34%. If it had an Irish tax liability on its Irish sourced profits, it would have been subject to Irish tax at 12.5% which would be creditable against its US taxes. Restructuring its business operations to ensure that 60% of its profits are now substantially subject to an effective tax rate of 12.5%, allows it to utilise pre US tax profits to fund its continuing expansion plans outside of the US. Of course there is a cost vs. benefit analysis required. GSECorp would have to weigh up the following:

Costs

- Value of foregone development tax deductions in the US.

- Tax cost of possibly not securing a tax deduction for the cost of buy in payments.
- The cost of any new withholding taxes resulting from the structure.
- Implementation costs.

Benefits

- What level of profits will be derived from the European operation?
- Will the tax liability on the above be deferrable under the US Controlled Foreign Corporation legislation (sub Part F)?
- Differential in tax rates (Ireland and rest of Europe) vs. US.

GSECorp will need to conduct a transfer pricing analysis to identify the transactional forms and the related allocations of functions, assets and risks to determine the level of profit that can justified in Ireland. The benefits, in terms of taxation, outweigh the costs.

4. Conclusion

As this paper hopefully demonstrates, the issue of what is or is not a PE is no easy matter. In my view the tests in determining whether a PE exists in a foreign jurisdiction that have been applied for conventional commerce can still be applied to e-commerce. There is, however, a need for the definition to be constantly kept under review as newer technology develops. Such revisions will always need to keep in focus the general taxing principles that have stood the test of time. Tax authorities in high tax jurisdictions will always have to contend with the ease with which, in a global environment, companies can relocate activities to low tax jurisdictions which typically have little or no transfer pricing regimes in their domestic tax legislation. In my view the OECD has to insist that its members (particularly in low tax jurisdictions such as Ireland) apply an internationally accepted transfer pricing model for all enterprises over a certain size. This would ensure that profit allocations in different jurisdictions are in line with the particular enterprise functions performed, assets engaged and risks assumed. Corporations would be required to have their auditors sign off as part of the annual audit an opinion that the corporation has a proper transfer pricing programme in place in conformity with the transfer pricing standard. Until such an internationally accepted transfer pricing model is accepted, a risk will always remain that the level of profits accruing in the low tax jurisdiction will not reflect the true level of economic return expected.

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