

*WHAT ARE THE PERMANENT ESTABLISHMENT ISSUES,
REGARDING THE TAXATION OF THE BITCOIN,
AND HOW CAN THEY BE SOLVED?*



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What are the permanent establishment issues, regarding the taxation of the Bitcoin, and how can they be solved?

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“This isn’t something that’s a flash in the pan. It’s something that’s going to be with us.”

-Senate Homeland Security and Governmental Affairs Committee (HSGAC) Aide²

Preface.

Apart from the efforts of myself, the success of any project depends largely on the encouragement and compassion of many others. I would like to take this opportunity to express my gratitude to the people that were helpful in the completion of this master thesis. I would like to express my gratitude to my supervisor mr. dr. D.S. Smit. Every meeting was an encouragement to work even harder, despite the difficulty of the subject you always kept faith in me. I would also like to thank the ones who supported me throughout the process, and helping me putting the pieces together.

Abstract.

The rise of the digital economy and the development of virtual currencies bring taxation issues regarding the constitution of a permanent establishment, more and more mismatches between law and technology appear. The rules of the permanent establishment were made a long time before the internet even existed, in that time it was not more than logical that if you wanted to do business in another country, you had to be based in that other country. But with the rise of the digital economy a physical presence is no longer required. For this reason internet-based companies earn a lot of money because they don't have sufficient physical presence in that country none of the countries can tax the company. The nexus should not be based on physical presence but on value creation and place of consumption. When the permanent establishment issue is solved, the following issue is the attribution of profits to that permanent establishment. There is not a lot of guidance available yet; this makes Bitcoin attractive for profit shifting and even tax evasion. It isn't clear whether the rules of yesterday can be effective for the businesses of tomorrow. For this reason the OECD is developing possible solutions in order to get the law up to date, and to stay up to date. When this is all clear one final step has to be taken; the allocation of income to the permanent establishment.

Register

Chapter one

1.1 What do we already know?.....	8
1.2 Specific issue.	9
1.3 Why is it important?.....	10
1.4 Methodology.....	11

Chapter two

2.1 Introduction.....	12
2.2 Closed economy.	12
2.3 Hybrid economy.	12
2.4 Open economy.	13
2.5 Conclusion.	15

Chapter three

3.1 The characterization of income from Bitcoin sales.	16
3.1.1 Currency.....	16
3.1.2 Property/intangible asset.	17
3.1.3 Voucher.	18
3.2 The issue of calculating the tax liability.	18
3.3 Conclusion.	19

Chapter four

4.1 How do different countries tax the Bitcoin?.....	20
4.2 USA.	20
4.3 Brazil.....	22
4.4 Estonia.	22
4.5 Denmark.....	23
4.6 Germany.....	24
4.7 The Netherlands.	24
4.8 The European Union.	24
4.9 Conclusion.	25

Chapter five

5.1 The classification of the person.	25
5.2 Analyses.....	27
5.3 Miners.....	27
5.4 Virtual currency software developers.	28
5.5 Investors.	28
5.6 Conclusion.	28

Chapter six	
6.1 Introduction.....	29
6.2 What is the Problem?.....	29
6.3 When are you subject to tax in domestic and international situations?	29
6.4 Conclusion.	32
Chapter seven	
7.1 Introduction.....	32
7.2 What is the problem?.....	33
7.3 The permanent establishment.	33
7.3.1 Modify the exemptions from the permanent establishment.	35
7.3.2 Establish a new nexus rule to use for digital businesses in the digital economy....	36
7.3.3 Create rules for the new virtual permanent establishments.	38
7.3.4 Impose a Withholding tax on digital transactions.....	41
7.3.5 Require non-resident vendors to collect VAT.	41
7.4 Analysis.....	42
7.5 Conclusion.	43
Chapter eight	
8.1 Introduction.....	45
8.2 Article 7 OECD model tax convention.	45
8.2.1 Paragraph one.	46
8.2.2 Paragraph two.....	46
8.2.3 Paragraph three and four.	48
8.3 characterization of a server that constituted a permanent establishment.....	49
8.4 Conclusion.	50
Chapter nine	
9.1 Conclusion	51
9.2 Answer of the research question.....	54
Chapter ten	
10.1 Recommendations.	56
10.2 VAT treatment of Bitcoin and its actors.	56
10.3 Other types of taxes.....	57
10.4 Issues regarding the permanent establishment.....	57
10.5 Issues regarding the profit attribution to permanent establishments.	57
10.6 Legal principles.	58
Chapter eleven	
11.1 Literature list.....	58

Chapter one

1.1 What do we already know?

The last decades have been marked by the rise of the digital economy and the development of virtual currencies¹. With the rise of the digital economy comes an end to the current system that is based on the actual geographic location of the buyers and sellers². Because enterprises operate through the internet it is hard, according to the current rules, to determine which country can tax, because it is unclear whether there is a permanent establishment or not. The rule according to the OECD model tax convention is that an enterprise in one state shall not be subject to taxes based on net income in the other state unless it carries on business in that other state through a permanent establishment located in that other state³. According to the OECD there are fundamental criteria for determining if a permanent establishment is constituted⁴:

- There must be a fixed place of business
- This fixed place must be located in a certain territory
- The use of the fixed place must last for at least a certain period of time
- The taxpayer must have a certain right of use over the fixed place
- Activities performed through the fixed place must be of a business character, as defined in treaty law and domestic law

In the pre-digital world this was an effective criterion to require a physical presence in a non-resident state. Nowadays companies can do business in non-resident states without having a physical presence in that state, through the Internet. With the rise of the digital economy also came the development of digital currencies. These virtual currencies are units of exchange but they are not backed by any government-issued legal tender⁵. They come in three different types. On the one hand some virtual currencies can only be used in one virtual world like “World of War craft”⁶ they can’t be bought with real currency. This is called a “closed flow” economy. However some of these virtual currencies that are meant for one specific virtual world can be

¹ OECD, “Public discussion draft; BEPS action 1: address the tax challenges of the digital economy”, (March 24, 2014).

² Benjamin Hoffart, “Permanent establishment in the digital age: improving and stimulating debate through an access to markets proxy approach”, *Northwestern journal of technology and intellectual property*, volume 6, (fall 2007), Issue 1, p.1.

³ Benjamin Hoffart, “Permanent establishment in the digital age: improving and stimulating debate through an access to markets proxy approach”, *Northwestern journal of technology and intellectual property*, volume 6, (fall 2007), Issue 1, p.1.

⁴ Gary D. Sprague & Rachel Hersey, “Permanent Establishments And Internet-Enabled Enterprises: The Physical Presence and Contract Concluding Dependent Agent Tests”, (2003), 38 GA. L. REV. 299, 299.

⁵ Benjamin Guttman, *The Bitcoin bible gold edition: all you need to know about Bitcoins and more*, (Books on demand, United States of America, 2013), p.13

⁶ Benjamin Tyson Duranske, *Virtual law: Navigating the legal landscapes of virtual world*, (American bar association, United States of America, 2008), P.238

changed for real currencies or they can be used to purchase actual goods or services⁷. This is an example of a “hybrid flow” economy.

Then there are the so-called “crypto currencies”⁸. This type of virtual currencies is developed primarily to buy real goods and services. All lines are open; Bitcoins can be used to buy goods but they can also be used to be transferred back to real currency. This is called an “open flow” economy. The most famous crypto currency is the Bitcoin. More and more private operators are accepting payments in Bitcoins⁹.

The fact that these currencies increase in economic value raises issues. Some of these issues rise in value, from the fact that the transactions with these currencies can be completely anonymous.

1.2 Specific issue.

Due to the rise of the digital economy, more and more mismatches between law and technology arise¹⁰. The nature of the digital economy fundamentally challenges physical presence-based permanent establishment rules. If current rules remain effective in the new economy, the permanent establishment components which were developed for the economy as it was almost a hundred years ago, must be reconsidered in order to fit in the new digital economy.

By now everyone has at least heard of Bitcoin. But it is not clear to everyone what Bitcoin exactly is and even less clear is how it should be taxed. We have seen that Bitcoin is normally described as a “virtual currency”. But is it really a currency, and more important should it be taxed as a currency?¹¹ Or should it be seen as a capital asset or maybe a voucher? Governments are studying how to treat these virtual currencies but until there is a satisfying answer it will be anyone’s guess¹².

⁷ United states government accountability office, “virtual economies and currencies additional guidance could reduce tax compliance risks”, (may 2013).

⁸ Benjamin Guttman, *The Bitcoin bible gold edition: all you need to know about Bitcoins and more*, (Books on demand, United States of America, 2013), p.18

⁹ Stephanie Soong Johnston, “news analysis: the tax implications of Bitcoin”, (march 20, 2014).

¹⁰ Benjamin Hoffart, “Permanent establishment in the digital age: improving and stimulating debate through an access to markets proxy approach”, *Northwestern journal of technology and intellectual property*, volume 6, (fall 2007), Issue 1, p.1.

¹¹ Jacob S. Farber et al, “IRS clarifies tax treatment of Bitcoin and other convertible currencies”, (march 26th, 2014).

¹² United states government accountability office, “virtual economies and currencies additional guidance could reduce tax compliance risks”, (may 2013).

From several reports is concluded that for now virtual currencies probably can be seen as capital assets since it has limited use, it is not generally accepted, as money¹³. However when these virtual currencies gain wider commercial acceptance they would more likely have to be seen and taxed as actual money. But what if a virtual currency becomes, for tax reasons, the same as a legal currency? In this case profits from sales are taxed as income. Also the mining of the virtual currency would be in this case taxed¹⁴. Another issue in the world of virtual currencies is the issue that there are wallets, which are used to store your virtual currency, that are blocking the government's ability to electronically track the currency¹⁵.

The research question for this master thesis will be: *What are the permanent establishment issues, regarding the taxation of the Bitcoin, and how can they be solved?*

1.3 Why is it important?

Internet-based enterprises might allow non-resident entities to get big gains from sales in another jurisdiction without having sufficient physical presence in that jurisdiction to give it the status of a permanent establishment. In the digital economy the test should not be based on physical presence, but should be based on sufficient nexus with the other state. It should be based on value creation but also the place of consumption should be taken into consideration. This change should also govern the amount of profits that should be allocated to a server for tax purposes by determining what substantive economic activities the server is conducting¹⁶.

Regarding the Bitcoin the sale or exchange of convertible virtual currency, or the use of convertible virtual currency to pay for goods and services in a real-world economy transaction, has tax consequences that may result in tax liabilities¹⁷. More guidance is needed if virtual currencies become more widely adopted. For issues like profit shifting and illegal activities the question needs to be raised whether Bitcoins are subject to information reporting requirements. Tax evasion using virtual currencies like Bitcoin is starting to appear more and more¹⁸. Tax

¹³ United states government accountability office, "virtual economies and currencies additional guidance could reduce tax compliance risks", (may 2013).

¹⁴ Tyler S. Robbins, "Bitcointax.info- A primer on Bitcoin taxation in the US". (March 25, 2014).

¹⁵ John Marthinsen, *Managing in a global economy: Demystifying international macroeconomics*, (Business and economics, United States of America, Feb. 25, 2014), P.283

¹⁶ Benjamin Hoffart, "Permanent establishment in the digital age: improving and stimulating debate through an access to markets proxy approach", *Northwestern journal of technology and intellectual property*, volume 6, issue 1, (fall 2007) p.1.

¹⁷ Tyler S. Robbins, "Bitcointax.info- A primer on Bitcoin taxation in the US". (March 25, 2014).

¹⁸ Jason M. Farrel, "Did the IRS just make Bitcoin a new tax loophole?", (April 7, 2014).

evaders find virtual currencies attractive because they offer a degree of secrecy therefore the amount of money involved is rising every day¹⁹.

1.4 Methodology.

For this master thesis I will use the legal method. Due to the lack of harmonization in the area of Bitcoin taxation, the emphasis will be put on a few jurisdictions, which have already started to apply Bitcoin taxation in their legislation. If this does not give a satisfying result I will complement this information with academic literature. First I will use the descriptive method to describe what a Bitcoin and a permanent establishment is and how they are treated now. In the subsequent parts of this master thesis the analytical and teleological method will be used to further explore the problem. The problems that are dealt with in this master thesis will be in the light of international taxation and economics.

In order to answer the research question properly, we first need to answer some sub-questions. It is important to know what the domestic situation regarding Bitcoin is before we can take a look at the international situation. In chapter two we are going to see in what economy we can find Bitcoins, and find out how they enter into circulation in order to narrow down our scope. Because the digital economies brings new ways to reach customers and there is no clear guidance on Bitcoin taxation we now have to find out how Bitcoins can be characterized t this moment. After this, another problem arises when the characterization is clear, this is the issue of calculating the tax liability, these problems will therefore be the subject in chapter three. Now we know how Bitcoins can get taxed in domestic situations it is time to look how countries actually tax Bitcoins domestically, this will be done in chapter four, in this chapter various countries will be reviewed on their Bitcoin taxation. Now we know in which economy our scope is, how Bitcoins can be characterized, and how different countries actually tax them, we have enough knowledge to look at the international issues the Bitcoin brings regarding permanent establishments and profit attribution. In the Bitcoin community there are different actors, first we need to define them, they will be defined according to the rules of the financial crimes enforcement network, and then we have to look whether they fall under the bank secrecy act or not. This will be the subject of chapter five. In chapter six we get to know in what situations you can be subject to taxes via residency and permanent establishment. Now we have seen that with the rise of the digital economy physical presence isn't necessary anymore to conduct business with another country, we will look at the problems of the current permanent establishment definition, and discuss some options to take away these problems, in chapter seven. When this

¹⁹ Jason M. Farrel, "Did the IRS just make Bitcoin a new tax loophole?", (April 7, 2014).

problem is solved we have one issue to go: the attribution of income to the permanent establishment. This issue will be discussed in chapter eight. To wrap it all up and answer the research question chapter nine will be the conclusion. In chapter ten I will give my recommendations were possible.

Chapter 2

2.1 Introduction.

In the last years we have seen the development of virtual economies, such as in online games. Within some of these virtual economies, virtual currencies are used for the exchange of goods and services²⁰. In some cases virtual currencies can be used to obtain real goods or services. There are three kinds of economies in which virtual currencies can be used; the closed economy, the hybrid economy and the open economy²¹. Transactions in virtual economies could produce taxable income depending on the structure of the economy. This is the conclusion of the Government Accountability Office, which stated that some types of virtual transactions should be taxed. They also said that transactions in a closed economy are likely not to be taxed. However, transaction taking place in a hybrid or open economy, in which real government-issued money can be converted to virtual money, should be taxed. The three types of virtual economies will be discussed in this chapter.

2.2 Closed economy.

In a closed economy, a virtual currency can only be used in the virtual environment to buy virtual goods or services, for example virtual tools that can be used in an online role playing game²². These virtual tools can be traded or sold within the closed virtual economy. Outside this virtual economy these tools have no value, and therefore cannot be sold for any government-issued money²³.

2.3 Hybrid economy.

In a hybrid economy, flows of money between virtual currency and any government-issued money exist, but one or multiple flows are closed. This is the thing when people can buy virtual currency with real government-issued money. However, maybe the virtual currency cannot be

²⁰ Benjamin Guttman, *The Bitcoin bible gold edition: all you need to know about Bitcoins and more*, (Books on demand, United States of America, 2013), p.96.

²¹ United States Government Accountability Office, "Virtual Economies and Currencies", (May 2013).

²² United States Government Accountability Office, "Virtual Economies and Currencies", (May 2013).

²³ Benjamin Guttman, *The Bitcoin bible gold edition: all you need to know about Bitcoins and more*, (Books on demand, United States of America, 2013), p.96.

traded back to real money. Massive multiplayer online role-playing games better known as MMORPG's, such as World of Warcraft, are a good example for a hybrid economy²⁴. Most of these games start as a closed economy but sometimes leak to hybrid economies.

2.4 Open economy.

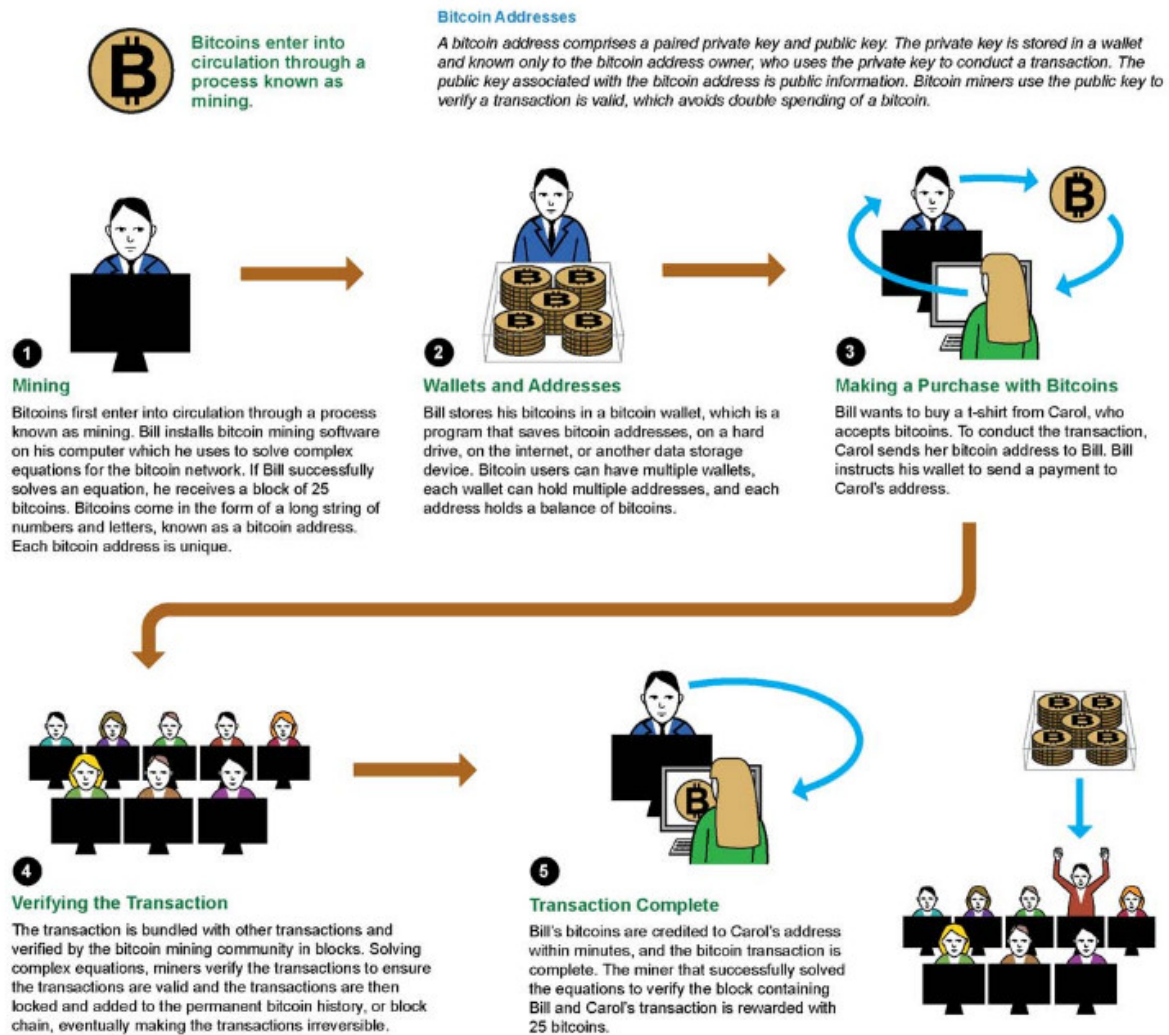
In an open economy, virtual currencies can be used to buy both real and virtual goods and services, the virtual currency can also be exchanged for real government-issued money. An example for this type of economy where they use virtual money that can be bought and exchanged for real money is second life²⁵. In second life people can exchange real money for Linden dollars but they can also use their Linden dollars to buy real money²⁶.

Another type of open economy does not need a virtual economy like a MMORPG. A virtual currency can be also developed and designed to buy real goods and services. An example for this is the Bitcoin, a decentralized digital currency that makes use of a p2p network to move the Bitcoin from the sender to the recipient. Transactions in this type of virtual economy could produce taxable income in different ways depending on the facts and circumstances. But Bitcoin is not the only example who makes use of a peer 2 peer network, other virtual currencies are: Litecoin, Peercoin, and Ripple. How do these “coins” enter into circulation?

²⁴ Mannatt, Phelps & Phillips, LLP, *Virtual currency*, April 2013, Mannatt

²⁵ Benjamin Guttman, *The Bitcoin bible: all you need to know about Bitcoins*, (Books on demand, United States of America, December 2013), p.97.

²⁶ Mannatt, Phelps & Phillips, LLP, “Virtual currency”, (April 2013), Mannatt



1. Bitcoins enter into circulation when they are mined, mining means solving complex equations for the Bitcoin network. Bitcoins are mined in blocks; currently each block contains 25 Bitcoins.
2. The mined Bitcoins are stored in electronic wallets, mostly these wallets are held in the cloud. Bitcoin users can have multiple wallets, the accounts that are linked to these wallets can be anonymous.
3. Bitcoins can be used for purchasing goods and/or services from people that accept Bitcoins.
4. The transaction needs to be verified, and then locked and added to the permanent Bitcoin history.
5. After this the transaction will be complete in a few minutes. The Bitcoins are transferred to the wallet of the seller.

²⁷ Paul Roberts, "Beware Bitcoin users: The tax man cometh", (June 18 2013), The security ledger

2.5 Conclusion.

Transactions within virtual economies or using of virtual currencies can produce taxable income as we have seen this depends on the various facts and circumstances within the economies.

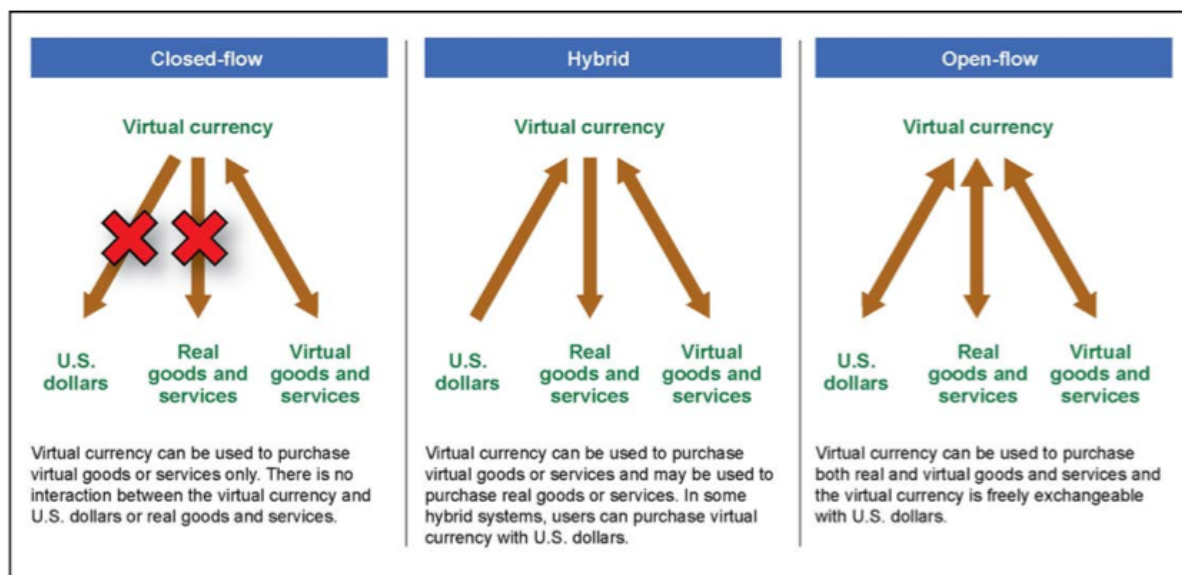
Transactions within a closed economy cannot produce a taxable income because virtual currency in this type of economies can only be used to buy virtual goods and/or services. The best example for a transaction in a closed economy is someone buying an item in an online game.

Only in hybrid and open economies transactions can produce taxable income this is because the goods and service that can be bought or sold do have value in the real world. The virtual currency that is used in hybrid and open economies can be bought with real currency.

In this master thesis I will only look at the open economy because in the economy where the Bitcoin is found all lines are open. This means that Bitcoins can be bought with real money and Bitcoins can be traded back to real money.

28

Figure 1: Types of Virtual Currency Systems



²⁸ Paul Roberts, "Beware Bitcoin users: The tax man cometh", (June 18 2013), The security ledger.

Chapter three

3.1 The characterization of income from Bitcoin sales.

Products and services can be provided to buyers in new business models since the digital economy has developed itself²⁹. These new ways raise questions how to characterize this income derived from these new business models³⁰. This is important in the light of existing categorization of income and consistency of treatment of similar types of transactions. How do for example, Bitcoin transactions have to be taxed for both domestic and international purposes. Most taxpayers are aware that they may have a tax liability, but they don't know about the proper tax treatment of their virtual transactions. Depending on the characterization, the virtual (economic) activity or virtual currency can be treated for tax measures as currency, property, or a voucher. All of these possible characterizations will be discussed in this chapter. It is important to determine how Bitcoins need to be characterized to create legal certainty. People can't comply with something if they don't know how to comply, and what they have to pay.

3.1.1 Currency.

Bitcoin isn't the same as any national currency and the "coins" cannot be equated to physical coins or paper notes. Bitcoin doesn't have the criteria of a traditional currency, so for now it seems unlikely that any country will treat it as a currency³¹. Bitcoin isn't backed nor issued by a central government or bank³², like the European central bank is behind the Euro; it also isn't linked to another asset like gold, silver or bronze³³. This means that the bank secrecy regulations aren't applicable on Bitcoin because it isn't defined as a currency. Another reason that Bitcoin probably would not be treated as a currency is the fact that it isn't (yet) widespread enough and its lack of customary acceptance as money equivalent in any country³⁴.

When Bitcoins are treated as real (foreign) currency, all of the gains are subject to normal income tax rates and all losses can be deducted from ordinary income. When Bitcoins are treated as (foreign) currency it is easy to comply with the law because users owe regular income tax on gains. When they are treated as foreign currency the downside will be that the applicable tax rate on income derived from Bitcoin will be higher in most cases, because when you receive

²⁹ OECD, "Action plan on base erosion and profit shifting", OECD (2013).

³⁰ OECD, "Action plan on base erosion and profit shifting", OECD (2013).

³¹ Patrick Colabella and Michael Shoff, "Virtual Currencies: the challenge to global fiat paradigms", Proceedings of ASBBS, Volume 21 number 1, p172

³² Andrew S, "Bitcoin Taxation: understanding IRS Notice 2014-21", Bitcoin magazine, (April 4, 2014)

³³ Howard Wiener et al, "Chomping at the bit: U.S. federal income taxation of Bitcoin transactions", tax notes international, volume 73 number 4, (January 27, 2014) p.353.

³⁴ E. Follow, 'How do I report Bitcoin gains?', Bitcoin tax solutions, (January 2009).

Bitcoins they will be treated as ordinary income and taxed according to the income scale the receiver is in. But currency transactions are tax exempted, therefore this would be the most liberal way to treat them³⁵.

Private money is a slimmed down version of currency. If the Bitcoin gets taxed as private money it will be treated as a currency/financial instrument. Therefore the same rules should apply on Bitcoin that we apply to Euro's and Dollars. This decision enables users of Bitcoin to use it without any interference of the government, while at the same time the government gets the opportunity to tax profits of companies that use the Bitcoin³⁶. This decision would also lead to the independence of the Bitcoin while at the same time it removes one of the main objections that governments have against it³⁷. The treatment as private money would eliminate any kind of profit tax, for example capital gain taxes. This treatment would also result in a minimal tax liability for users of the Bitcoin because it is seen as a financial instrument which can be used daily to buy goods and/or services³⁸. This would be a good way to treat Bitcoin if it becomes a kind of money used for everyday use. Users don't have to keep track of when they used which Bitcoin, this saves a lot of time and therefore money.

3.1.2 Property/intangible asset.

If Bitcoins were treated as property then they would be taxed as assets, like gold and stocks³⁹, then they would be subject to capital gains taxes⁴⁰. A question that rises when they are treated as property; will Bitcoins classify as capital assets or as non capital assets⁴¹. This is an important distinction because in most countries when you hold your capital assets longer than one year they are generally subject to lower taxation rates than non capital assets⁴². But what is property income? Property income is the income receivable by the owner of a financial asset or a tangible non-produced asset in return for providing funds to or putting the tangible non-produced asset at the disposal of, another institutional unit; consists of interest, the distributed income of corporations, reinvested earnings on direct foreign investment, property income attributed to

³⁵ TMF group, "Bitcoin UK tax review to give currency global boost", Mondaq, (April 4, 2014).

³⁶ Peter Parker, "Bitcoin becomes "private money" in Germany", Cointelegraph, (April 21, 2014).

³⁷ Peter Parker, "Bitcoin becomes "private money" in Germany", Cointelegraph, (April 21, 2014).

³⁸ TMF group, "Bitcoin UK tax review to give currency global boost", Mondaq, (April 4, 2014).

³⁹ Richard Rubin and Carter Dougherty, "Bitcoin is property, not currency, in tax system: IRS", Bloomberg, (March 25, 2014).

⁴⁰ Andrew S, "Bitcoin Taxation: understanding IRS Notice 2014-21", Bitcoin magazine, (April 4, 2014).

⁴¹ Andrew S, "Bitcoin Taxation: understanding IRS Notice 2014-21", Bitcoin magazine, (April 4, 2014).

⁴² Edmund C. Moy, "Consequences of Bitcoin classified as property", (March 28, 2014).

insurance policy holders, and rent. In the case of Bitcoin it falls under the first mentioned, financial asset⁴³.

For investors who invest in Bitcoin this is a favorable ruling⁴⁴. This would mean on the one hand that people who are profiting from their investments in Bitcoin will have to pay the lower taxes which rest on capital gains, rather than the higher taxes which are levied on foreign currency. Another strength is that most tax laws allow taxpayers to subtract capital losses from any capital gains. On the other hand, for investors it means that they have to keep a detailed overview on their Bitcoin transactions⁴⁵. This isn't that of a problem when you use your Bitcoins as an investment, but it can be harder when you use your Bitcoins if them to buy goods and/or services on a regular basis.

This decision appears to be appropriate when it comes to Bitcoin investments, for those who use Bitcoin to pay for goods and services thus ruling may be cumbersome, because this would make it necessary to keep track of every purchase and the value of the Bitcoin at the time when the sale is made.

3.1.3 Voucher.

Vouchers have a monetary face value. Goods and services can be bought up to the face value of the voucher. When it comes to Bitcoin, if it's treated as a voucher to buy goods and services, it is subject to full VAT on the value of the Bitcoin that is sold. Under this treatment, local VAT rates are applicable every time that the Bitcoin is used. This level and scale of taxation would kill the Bitcoin market because it is much cheaper to use other alternatives⁴⁶.

3.2 The issue of calculating the tax liability.

It doesn't matter how Bitcoin is characterized the most difficult issue is calculating the actual tax liability. This is because tax has to be paid over Bitcoin income but for now no taxing body accepts payments in Bitcoin. Bitcoin sales have to be converted to a government-backed currency such as dollars or euros, when this is done the amount payable can be calculated⁴⁷. In order to do this it is important to keep track of every Bitcoin purchased and sold in order to

⁴³ E. Follow, "How do I report Bitcoin gains?", Bitcoin tax solutions, (January 2009).

⁴⁴ Richard Rubin and Carter Dougherty, "Bitcoin currency use impeded by IRS property treatment", Bloomberg news, (March 26, 2014).

⁴⁵ Richard Rubin and Carter Dougherty, "Bitcoin currency use impeded by IRS property treatment", Bloomberg news, (March 26, 2014).

⁴⁶ TMF group, "Bitcoin UK tax review to give currency global boost", Mondaq, (April 4, 2014).

⁴⁷ HMRC, "HMRC reviewing tax treatment of Bitcoin and other virtual currencies", (January 22, 2014).

know what its worth was at that moment. This is nothing new. Reinforcing this problem is the fact that the value of Bitcoins is not stable and can fluctuate hundreds of dollars/euros a day. Meaning that the value that has to be collected for sales tax due on the transaction can be a lot different from the time of remittance to the taxing agency. This becomes a problem when users of Bitcoin convert Bitcoins on later date, because the rate then differs from the actual moment of use of the Bitcoin. This can save a lot of money for the user, but it can also cost him a lot more.

There is not a lot of guidance yet, but this doesn't take away that the tax obligation still exists. Every transaction with any currency is subject to taxes. The fact that there is little to none guidance doesn't change this in any way. Non-compliance can result in high costs, for example for accounting fees or fines.

3.3 Conclusion.

It is important to characterize income derived from the new business models for both domestic and international purposes. Because most taxpayers know that there may be a tax liability, but they don't know the proper tax treatment. We have seen that for tax treatment Bitcoins can be characterized as (foreign) currency, property, and vouchers. From all characterizations we can conclude that when you own Bitcoins you are liable to tax. Bitcoins are taxable, whenever a taxable event occurs. The best ways to characterize Bitcoin is in my opinion as property or as currency; both characterizations have their pros and cons.

If Bitcoins are characterized as property Bitcoins will be taxed as capital gains. To see how much tax you owe you will have to keep track of the date when the Bitcoin was purchased, the date when you sold the Bitcoin, the price you paid for that particular Bitcoin, and the price you got for that Bitcoin. This isn't a big problem if you only invest in Bitcoins like they are stocks, but this becomes harder when you use Bitcoins on a day to day basis to buy goods and/or services. The second issue of characterizing Bitcoin as property is determining the value; the market determines the value. The rate applicable to property is low and the rate even falls more when the Bitcoins are held for more than a year.

When we characterize Bitcoins as currency, the gains would be subject to income tax and losses can be deducted from the income. Users of Bitcoin don't have to keep track of all their transactions, or which Bitcoin they have used when. This would make it easier for users to comply with the rules. The downside of the characterization as currency would be that Bitcoins

Bitcoin. Therefore Bitcoins are not taxed as currency so no foreign currency gains or losses can occur⁵⁰. However a taxpayer who receives Bitcoins as payment for goods and/or services must include the fair market value, measured in dollars, in their gross income. The basis will be the fair market value in dollars. This market value is determined by an exchange where Bitcoin is listed, and the exchange rate is established by market supply and demand. For this reason the taxpayer can have a taxable gain or loss upon an exchange of Bitcoin for other property⁵¹. This happens when the fair market value of the property that the taxpayer receives exceeds the adjusted basis of the Bitcoin, the taxpayer will have a taxable gain. The other way around the taxpayer will have a loss if the fair market value of the property received is lower than the basis of the Bitcoin he gave in return, this is a challenge for people who use Bitcoins on a daily basis because they have to keep track when they used which Bitcoin and what the fair value at that moment was. For a currency this wouldn't make sense because when you pay in dollars it doesn't matter which dollar you use to pay with from your wallet, this gives owners of Bitcoins the incentive to hoard there Bitcoins instead of using them⁵². When a person holds the Bitcoins as capital assets that person can realize a gain or a loss, but the Bitcoins can also be held as inventory for sale than these Bitcoins are not capital assets⁵³.

People who mine Bitcoins have to report the mined income as gross income. When this person mines for trade and business the net earnings are subject to self-employment tax. The same is true for a contractor who allows payment in Bitcoin. In both cases the fair market value measured in U.S. dollars as of the date of receipt is subject to self-employment tax⁵⁴. There can be an exception when the business is a hobby. The employer can also pay his employee in Bitcoin, when this happens this remuneration constitutes wages for employment tax purposes. The fair market value is then subject to income taxes. All payments made using Bitcoin that exceed \$600 need to be reported, and is taxable by the IRS. When Bitcoins are not treated as the law subscribes, taxpayers may be subject to penalties.

Although this guidance addressed some of the most pressing tax issues on virtual currencies, more guidance will be needed to completely understand the tax treatment of these currencies.

⁵⁰ The law library of congress, "Regulation of Bitcoin in selected jurisdictions", Global research center, (January 2014).

⁵¹ IRS, "IRS virtual currency guidance: virtual currency is treated as property for the U.S. federal tax purposes; general rules for property transactions apply", IR 2014-36, (March 25 2014).

⁵² Erik Kroh, "More U.S. guidance sought on Bitcoin and other virtual currencies", taxanalysts, (April 4, 2014).

⁵³ The law library of congress, "Regulation of Bitcoin in selected jurisdictions", Global research center, (January 2014).

⁵⁴ IRS, "IRS virtual currency guidance: virtual currency is treated as property for the U.S. federal tax purposes; general rules for property transactions apply", IR 2014-36, (March 25 2014).

The IRS guidance results in proper tax treatment of these virtual currencies but don't allow them to be functional currency⁵⁵.

4.3 Brazil.

The Recite Federal, the tax authority of Brazil, considers Bitcoin not as a currency. It looks like Brazil taxes them the same as the United States do. But Brazil makes a distinction between investors and consumers⁵⁶. Investors are subject to taxes but consumers are exempted from this rule⁵⁷. Brazil considers digital currencies to be financial assets; this means that when a digital currency gets sold a 15% digital sales tax is levied. But there is a threshold of 1600 dollar, when you stay under this threshold no tax is levied on the capital gains. This means that small consumer purchases are exempted. Brazil is not going to impose new regulations on digital currency trades.

4.4 Estonia.

Recently the Estonian Tax and customs board published how Bitcoin transactions are taxed in Estonia. They notice up front that the tax treatment of Bitcoins is not clarified at EU level yet and that developments at EU level can result in changes in the Estonian legislation regarding the tax treatment of this virtual currency⁵⁸.

The rules of the tax treatment of virtual currencies in Estonia are regulated in article 6 of the payment institutions act. Bitcoin is backed, by neither Gold, nor government, this means that it does not constitute a claim on the issuer. Another issue resulting from not being backed is that for this reason they are not seen as a virtual currency because Bitcoins do not match the standards as defined in the payment institutions and E-money institutions act. This also means that issuing Bitcoins is not considered as a payment service. Bitcoins can also not be seen as securities because they also don't meet the criteria of the securities market act because it is not clear who the issuer and the receiver are.

⁵⁵ The law library of congress, "Regulation of Bitcoin in selected jurisdictions", Global research center, (January 2014).

⁵⁶ The law library of congress, "Regulation of Bitcoin in selected jurisdictions", Global research center, (January 2014).

⁵⁷ The law library of congress, "Regulation of Bitcoin in selected jurisdictions", Global research center, (January 2014).

⁵⁸ The law library of congress, "Regulation of Bitcoin in selected jurisdictions", Global research center, (January 2014).

The use of virtual currency falls under the scope of the money laundering and terrorist financing prevention act, and therefore all these rules should be respected, because they are seen as alternative rules of payment⁵⁹.

In Estonia all financial services are exempt for VAT, according to the VAT directive. Most logical would be that the payments with Bitcoin or other virtual currencies would be exempted to, but these payments fall under alternative means of payment and do not fit in this exemption. Consequence to this is that every Bitcoin transaction in Estonia is subject to the general VAT rate. The VAT rate applicable is 20%. Article 15(1) of the income tax act rules that Bitcoins are ordinary assets. Therefore, Bitcoins are also subject to capital gains tax. Capital gains tax in Estonia is 21%, but there are deductions that may apply to virtual currency⁶⁰.

4.5 Denmark

Denmark approaches the tax treatment of Bitcoins quite the same as the United States of America but there are some differences⁶¹. Private Bitcoin transactions are not subject to VAT in Denmark because Bitcoins and other virtual currencies are not seen as legal currency. This ruling was given on the 25th of March. The fact that Bitcoin transactions are not subject to VAT also means that individuals who realize gains don't pay tax on these gains. On the other hand this also means that deductions for losses are not allowed either. However, businesses that trade Bitcoins are subject to income tax rules on the gains made in the normal course of business, losses from these transactions are deductible⁶². The board's opinion is that Bitcoin is not a legal currency because it had no physical form. Although Denmark and the United States of America came to the same conclusion, that Bitcoin is not a legal currency, differences in the countries' tax systems lead to different interpretations.

Concluding: in Denmark Bitcoin transactions are completely private, so no tax occurs. In the United States of America this is different because even private transactions are subject to tax in the U.S. unless there is a specific exemption.

⁵⁹ Erki Uustalu, "Estonian tax board clarifies tax treatment of Bitcoin transactions", taxanalysts, (April 3, 2014).

⁶⁰ Erki Uustalu, "Estonian tax board clarifies tax treatment of Bitcoin transactions", taxanalysts, (April 3, 2014).

⁶¹ The law library of congress, "Regulation of Bitcoin in selected jurisdictions", Global research center, (January 2014).

⁶² Stephanie Soong Johnston, "Private Bitcoin transactions are tax free, Danish tax board rules", taxanalysts, (April 10, 2014).

4.6 Germany.

In Germany the federal financial supervisory authority communicated on December 19 2013 that Bitcoins are financial instruments, and more specifically a unit of account⁶³. They fall in this category because Bitcoins are related to foreign currencies. Accordingly, Bitcoins are units that are not expressed in the form of legal tender. But they are units of value that can be used by individuals and companies to buy goods and/ or services⁶⁴. Units of account do not require bank supervisory licensing. However under certain circumstances licensing could become needed. In some cases Bitcoins are subject to discussion, there are statements to tax Bitcoin transactions with VAT because the lack of income tax effects for example when the Bitcoins are held for longer than one year.

4.7 The Netherlands.

In The Netherlands, Bitcoins fall out of the scope of the act on financial supervision (wet op het financieel toezicht). But that does not mean that Bitcoins are not taxed in The Netherlands on the contrary, Dutch people who accept payments in Bitcoin or other virtual currency will have to pay income tax on the funds they receive⁶⁵. Bitcoins cannot be seen as electronic money, because according to Dutch law four criteria have to be fulfilled to be electronic money: first it has to be stored electronically, second, it has to represent a claim on the person or organization who issues the electronic money, thirdly it has to be issued in exchange for money to make payments with, and finally it can be used to pay both the issuer and others⁶⁶. Bitcoins do not represent a claim on the person or organization that issues it and they are not necessarily issued for money, since you can mine them. The law on income does not mention money as income it just mentions income. Income is defined as and money, goods including Bitcoins. This is the reason income tax has to be paid. The problem with this is that the Dutch tax office only accepts money, so a liquidity problem can occur. Questions are asked whether the legal definition of digital currency needs to be revised in anticipation that virtual currencies will increasingly function as money.

4.8 The European Union.

In the European Union no specific legislation for virtual currency has passed yet. The European Central Bank (ECB) issued a report on virtual currency schemes that discusses the virtual

⁶³ The law library of congress, "Regulation of Bitcoin in selected jurisdictions", Global research center, (January 2014).

⁶⁴ The law library of congress, "Regulation of Bitcoin in selected jurisdictions", Global research center, (January 2014).

⁶⁵ The law library of congress, "Regulation of Bitcoin in selected jurisdictions", Global research center, (January 2014).

⁶⁶ Branko Collin, "Bitcoin income shall be taxed, Dijselbloem says", 24 oranges, (June 2013).

currency and Bitcoin systems and analyzes them according to existing EU legislation. This report concludes that the Bitcoin scheme may fall within the definition of the electronic money directive from 2009⁶⁷. Electronic money is in this directive defined on three criteria: the first one is electronic storage, the second is issuance upon receipt of funds, and finally acceptance as means of payment by a legal or natural person other than the issuer⁶⁸. This reports states that Bitcoins meet the first and the third criteria. It could also be possible that the Bitcoin falls in the definition of payment services directive. In this directive rules are made for payments through electric money. In the report of the ECB the conclusion is that Bitcoin transactions also fall out of the scope of this directive because this directive does not cope with electronic money transactions and because the payment institutions are not allowed to issue electronic money.

4.9 Conclusion.

Most countries use the same characterization to tax Bitcoin transaction, but because every country's domestic laws differ the outcome per country will never be the same. Most countries tax Bitcoin as property, for now. In my opinion, when Bitcoins are getting more widely adopted and used, most countries will switch their tax treatment on Bitcoin to currency.

Chapter five

5.1 The classification of the person.

Now we know that our focus is in the open economy, and that we have seen how Bitcoin transactions can be characterized. We know now what the domestic situations are, this was important to have clear before we could get to the international aspects. The first thing we need to investigate is who the actors are in the Bitcoin world and how they are treated. In The United States there is an organization called the financial crimes enforcement network (finCEN). The finCEN established rules on how Bitcoins need to be reported and who needs to report them, almost all countries have similar rules regarding this subject. In order to know how they should be taxed we first have to fit the actors of the Bitcoin world into the three actors the finCEN has defined.

How do Bitcoin gains need to be reported, and who needs to report them? The right way to treat Bitcoins for tax reasons is generally uncertain and differs all over the world, as we have seen⁶⁹.

⁶⁷ The law library of congress, "Regulation of Bitcoin in selected jurisdictions", Global research center, (January 2014).

⁶⁸ The law library of congress, "Regulation of Bitcoin in selected jurisdictions", Global research center, (January 2014).

⁶⁹ E. Follow, "How do I report Bitcoin gains?", Bitcoin tax solutions, (January 2009).

The main issue is as we have seen whether the virtual currency is seen as property, a (foreign) currency or maybe something else⁷⁰. Strong arguments for all options have been made and there is no answer yet, so it is impossible to give a definitive answer. Tax attorneys can interpret the law in order to reach an answer that is the best answer for their case. But until there is official guidance nothing is certain. According to the FinCEN there are three probable actors: users, administrators and exchangers⁷¹. The FinCEN is regulating the bank secrecy act (BSA) to persons creating, obtaining, distributing, exchanging, accepting or transmitting virtual currencies. For governments this is an important issue because bank secrecy lowers tax income, everything has to be as transparent as possible. With almost all bank secrets gone in real currency they are not fond of doing it all over again, but now for virtual currencies⁷².

A user who obtains Bitcoins and uses it to buy goods and/or services is not a money services business (MSB) under the regulations of the FinCEN. The use of Bitcoins does not fall under the rules of money transmission services and therefore they don't have to register, report, and keep records for MSB's⁷³.

Administrators and exchangers need to fulfill one of the two criteria. They either have to accept and transmit a convertible virtual currency, or they have to buy or sell convertible currency. When they fulfill one or both of these criteria they are seen as a money transmitter under the rules of the FinCEN, unless there is an exemption that applies to that person⁷⁴. A money transmitter is a person that provides money transmission services, or any other person engaged in the transfer of funds, this term is the same for transmitters in real currency as it is in virtual currency. The term money transmitting services means: the acceptance of currency, funds, or other value that substitutes for currency from one person to another. There are three different kind of brokers and dealers in the virtual world; brokers and dealers of e-currency and e-precious metals, centralized and convertible virtual currencies, and de-centralized convertible virtual currencies⁷⁵.

The FinCEN ruled that administrators are persons engaged as a business putting Bitcoins into circulation, and who have the authority to redeem these Bitcoins from circulation. Exchangers

⁷⁰ Robert A. Green, "The tricky business of taxing Bitcoin", Forbes magazine, (December 2013).

⁷¹ Greg Egan, "FinCEN responds to Bitcoin Community's request for clarification", (January 2014).

⁷² Greg Egan, "FinCEN responds to Bitcoin Community's request for clarification", (January 2014).

⁷³ Jamal El-Hindi, "Application of FinCEN's regulations to virtual currency mining operations", Department of the treasury financial crimes enforcement network, (January 30, 2014).

⁷⁴ Greg Egan, "FinCEN responds to Bitcoin Community's request for clarification", (January 2014).

⁷⁵ Department of the treasury financial crimes enforcement network, "Application of FinCEN's regulations to virtual currency mining operations", (January 2014).

are persons who are also engaged as a business in the exchange of the virtual currency for real currency, funds or other virtual currency. All persons who obtain Bitcoins in order to buy goods and/or services are users. Users cannot be money services businesses under FinCEN regulations⁷⁶.

5.2 Analyses.

The above mentioned is still rather vague. The FinCEN stated that users can't be money services businesses (MSB) but does this mean that the other two can be MSB's? To answer this question we have to look at the ruling of the FinCEN what money services businesses are⁷⁷. According to this ruling you are a MSB when you fulfill one of the following two criteria: you have to accept and transmit Bitcoins, or you have to buy or sell Bitcoins⁷⁸.

This makes it a little bit clearer, but still it isn't exactly clear how to fit in the various actors of the Bitcoin community into this picture. The main issue is how to fit miners of Bitcoins, virtual currency software developers, and investment activities into this picture, because they fit into the picture of multiple actors. Some were concerned that it created a dynamic structure where miners who used the Bitcoins they mined to purchase goods and/or services were classified as users, but on the other hand miners who are selling Bitcoins they mined for real currency were money transmitters. The FinCEN came with a solution for this problem⁷⁹.

5.3 Miners.

Before we can categorize the miners of Bitcoins we first have to have clear what mining exactly is. Mining is the processing of transactions in the digital currency system, in which the records of current Bitcoin transaction, known as blocks, are added to the record of past transaction, known as the block chain. According to the FinCEN, an individual or a company that uses Bitcoins that it mined itself, for its own benefit, the company has neither accepted nor transmitted and for this reason does not entail a money transmission⁸⁰. When the individual or company converts its Bitcoins, which they have mined themselves, into real currency, the individual or company is not acting as an exchanger as long as the transaction is made for the

⁷⁶ Jamal El-Hindi, "Application of FinCEN's regulations to virtual currency mining operations", Department of the treasury financial crimes enforcement network, (January 30, 2014).

⁷⁷ Department of the treasury financial crimes enforcement network, "Application of FinCEN's regulations to virtual currency mining operations", (January 2014).

⁷⁸ Greg Egan, "FinCEN responds to Bitcoin Community's request for clarification", (January 2014).

⁷⁹ Department of the treasury financial crimes enforcement network, "Application of FinCEN's regulations to virtual currency mining operations", (January 2014).

⁸⁰ Greg Egan, "FinCEN responds to Bitcoin Community's request for clarification", (January 2014).

own benefit of the individual or company and it is not a service for a third party⁸¹. It does not matter to who the Bitcoins are sent, the only thing that does matter is what the person is using the Bitcoins for, and who is benefitting from the transaction⁸².

5.4 Virtual currency software developers.

The second type of actors who need attention are the developers of virtual currency software. For this type of actors the FinCEN looked at two things namely: whether or not a company becomes an MSB if it creates software to facilitate the purchase of virtual currencies from sellers for purposes of its own investment when such software automates the collection and payment of legal tender currency to the seller of virtual currency, and secondly whether a company's periodic investment in convertible virtual currencies would make the company a MSB⁸³. This means that the mere production and distribution of software does not make a company a MSB, because they do not trade in the currency themselves.

5.5 Investors.

The next question that needs to be answered is whether investing in Bitcoins makes someone a MSB. We can go short on this answer; as long as the investor is investing on its own behalf and not on behalf of other investor he is not a MSB. If third parties occur then it may constitute a MSB.

5.6 Conclusion.

As we have seen the FinCEN has created rules to determine the actors in the digital economy. But it was not clear how to fit the actors of the Bitcoin into the actors of the FinCEN. In this chapter I have determined how miners, virtual currency software developers, and investors have to be seen in the light of the FinCEN. From this we can conclude that the most important criteria is whether they mine the Bitcoins for themselves or not, and the fact that virtual currency developers aren't a MSB as long as they do not trade in Bitcoin themselves.

⁸¹ Department of the treasury financial crimes enforcement network, "Application of FinCEN's regulations to virtual currency mining operations", (January 2014).

⁸² Howard Wiener et al, "Chomping at the bit: U.S. federal income taxation of Bitcoin transactions", tax notes international, volume 73 number 4, (January 27, 2014) p.353.

⁸³ Department of the treasury financial crimes enforcement network, "Application of FinCEN's regulations to virtual currency mining operations", (January 2014).

Chapter six

6.1 Introduction.

In chapter five the actors were discussed to get to know if they are subject to the rules the finCEN made. This was important because we know now that as long as the actors are acting on their own behalf and not on behalf of someone else they are not a money service business and for this reason they are not held to the rules of the bank secrecy act. In this chapter we are going to look when someone is subject to tax in domestic and in international situations, and what difficulties arise from this, MSB's are excluded from this chapter. The starting point for this will be the OECD model tax convention because most international tax treaties are based on this model convention.

6.2 What is the Problem?

Bitcoin mining and Bitcoin transactions are mostly operated from the software as a service model, which operates through the cloud. This model gives the user access to applications from various devices through a client interface such as a web browser. These services can be provided to businesses as well to consumers⁸⁴. The consumer of the service hereby usually does not manage or control the cloud infrastructure needed to provide the service. This service model is used a lot by payment services. The payment provider acts as an intermediary between online purchasers and sellers. These intermediaries accept multiple payment forms, under which credit card payments but also Bitcoin payments. Then they deposit the funds to the sellers account. Payment providers usually charge a fee for each completed transaction. The main international tax issues are the fact that the permanent establishment definition is too narrow, for this reason companies in the cloud don't qualify as a resident and therefore they won't be taxed. Another issue is the tax evasion issue. I will evaluate these options in the light of the international taxation issues of the Bitcoin⁸⁵.

6.3 When are you subject to tax in domestic and international situations?

This is the question that needs to be answered. Member states can only tax a resident⁸⁶. Whether you are a resident or not depends on domestic laws. The concept of resident of a contracting state has multiple functions and is important for resolving situations where double taxation can

⁸⁴ Alvarez and Marsal, "server as a permanent establishment: are your server's activities creating a taxable presence that you are unaware of?" (August 08, 2012)

⁸⁵ Alvarez and Marsal, "server as a permanent establishment: are your server's activities creating a taxable presence that you are unaware of?" (August 08, 2012)

⁸⁶ CFE Fiscal committee, "opinion statement fc 7/2014 of the CFE on the OECD discussion draft: addresses the tax challenges of the digital economy", (April 2014).

occur⁸⁷. Double taxation can occur when both states claim residency of the taxpayer. Generally speaking domestic laws of both states impose a tax liability based on the person's attachment to the state of residence. This liability is not only imposed on persons who are domiciled in that country but also for persons who stay in the territory of that state continually or for a certain period. In international situations double tax conventions do not concern themselves with domestic law, they lay down the conditions under which a person is to be treated fiscally as a resident and therefore is fully liable to taxes in that country. The states take their stand entirely on the domestic law. This can be seen in cases where no conflict occurs at between two residences, but where the conflict occurs between other factors such as residence and source or situs. In these cases special provisions have to be made in the double tax convention to determine which country is given the taxing rights⁸⁸. Article 4 of the OECD model convention is the resident article in this article is laid down: *"For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein"*⁸⁹.

The main problem is that domestic and international rules were established before the digital economy even existed, for this reason the rules are based on the outdated principle of a physical nexus in the taxing jurisdiction. This means that a non-resident person would require a form of physical presence to do business with his customer located in the other state, according to article 5 of the OECD model tax convention. First we need to know what is in this article⁹⁰:

Article 5

Permanent establishment

1. For the purpose of this convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
2. The term "permanent establishment" includes especially:
 - a. A place of management;
 - b. A branch;
 - c. An office;

⁸⁷ OECD, "Commentary on article 4 concerning the definition of resident", (2014)

⁸⁸ OECD, "Commentary on article 4 concerning the definition of resident", (2014)

⁸⁹ Article 4, OECD model tax convention.

⁹⁰ Article 5, OECD model tax convention.

- d. A factory
 - e. A workshop, and
 - f. A mine, an oil well, a quarry or any other place of extraction of natural resources.
3. Establishment only if it lasts more than twelve months.
- A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.
4. Notwithstanding the preceding provisions of this article, the term permanent establishment shall be deemed not to include:
- a. The use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
 - b. The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
 - c. The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
 - d. The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
 - e. The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
 - f. The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.
5. Notwithstanding the provisions of paragraphs 1 and 2, where a person – other than an agent of an independent status to whom paragraph 6 applies – is acting on behalf of an enterprise and has, and habitually exercises, in a contracting state an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that state in respect of any activities which that person undertakes for the enterprise, unless the activities of such persons are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provision of that paragraph.
6. An enterprise shall not be deemed to have a permanent establishment in a contracting state merely because it carries on business in that state through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

7. The fact that a company which is resident of a contracting state controls or is controlled by a company which is a resident of the other contracting state, or which carries on business in that other state (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

With the rise of the digital economy this physical presence is no longer needed, because persons can sell their goods in another country through the digital economy without having a physical presence in that other country⁹¹. This means that the domestic country doesn't tax because the transaction is in another contracting state; they have given away their taxing rights according to the OECD model convention. On the other hand the other contracting member state doesn't tax either because the business doesn't have a physical nexus in that state. This raises questions whether the tax rules to be changed in order to correctly tax the digital economy.

6.4 Conclusion.

In domestic situations, domestic law determines who is a resident of that state and who is not. In international situations the OECD model tax convention determines that *any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof*, is a resident. When the company does transactions with other countries, the taxing rights are given to that other country. With the rise of the digital economy it isn't sure that the other country will tax, because there is no permanent establishment in that other country, meaning that they don't see a resident. These issues arise from the fact that domestic and international rules were established before the digital economy even existed, for this reason the rules are based on the outdated principle of a physical nexus in the taxing jurisdiction.

Chapter seven

7.1 Introduction.

Before the rise of the digital economy, multinational did set up physical intermediaries in the markets they wished to penetrate. These physical intermediaries constituted a permanent establishment under existing tax treaties, and therefore triggering source-based taxation. Nowadays multinationals have more possibilities, under which is doing their business through

⁹¹ A.J. van Dongen, "Kwalificatie van een server als vaste inrichting", Rotterdam, (June 2012).

websites. This increases competitiveness and huge cost savings because no building and sales employees are needed.

7.2 What is the problem?

The digital economy is known for its volatility as a result of the rapid evolving technology. The risks of the digital economy that may occur are the risks of base erosion and profit shifting in both direct and indirect taxation⁹². Therefore taxation in the market country may be minimized by avoiding a taxable presence or by shifting profits through structures that maximize deductions in higher- tax jurisdictions. Another risk is withholding tax at source to be minimized. Other issues that arise in international taxation arise from the fact that the digital economy is intangible and its mobility, and the fact that it got even more mobile through time, this makes it even harder to tax. These circumstances expand the opportunities to expand base erosion. In the digital economy there is much less need for a company to be actually established there in order to carry on a business, this issue is called the nexus problem⁹³. Another problem is how value is created from creating, collecting or manipulating data and how this is attributed for tax purposes. The next question is how it should be characterized as we have seen in a previous chapter. Administrative issues do also derive from the digital economy because there are no borders. It is especially hard to identify who and what someone is providing and in which jurisdiction they do what they do. For tax reasons it is hard to determine what law is applicable and to determine their state of residence. Therefore we need to know what the restriction from the permanent establishment definition are, because when a company is operating through the Internet with customers in other countries the only way they can be a resident is via a permanent establishment.

7.3 The permanent establishment.

It is important to know what the term permanent establishment means. The term permanent establishment means a fixed place of business through which the business of an enterprise is wholly or partly carried on, as we have seen in article five of the OECD model tax convention. The key parts of this definition are: fixed place of business, and business of an enterprise is wholly or partly carried on. When do you fulfill these criteria? The OECD comments on article five explain this.

⁹² OECD, "BEPS action 1: address the tax challenges of the digital economy", (24 March 2014).

⁹³ CFE Fiscal committee, "opinion statement fc 7/2014 of the CFE on the OECD discussion draft: addresses the tax challenges of the digital economy", (April, 2014).

The term “fixed” means that it must be established at a certain place with sufficient degree of permanence. There also has to be a place of business, this means that there has to be a place where the activities are performed through for example machinery or equipment. Furthermore “fixed” has to have a link with a geographical point, but it doesn’t mean that this geographical point also has to be fixed to the ground⁹⁴.

The activities of the company must be carried out through the fixed place of business. This means that persons should be involved, the enterprise as to be dependent on the personnel who conduct the business of the company.

Paragraph two and three, of article 5 of the OECD model tax convention define what is included to be a permanent establishment, and paragraph four defines what is excluded. Paragraph four lists a number of examples, for enterprises not considered to have a permanent establishment. The common feature of these activities is the fact that they are preparatory or auxiliary.

With the destabilization of the traditional concept of a permanent establishment, the attention went to servers and website for the possibility for them to constitute a permanent establishment. Due to the volatility of the digital economy, and the new business models that can be operated through this economy, the permanent establishment definition is outdated. New business forms don’t constitute a permanent establishment where they should do.

Can the rules of yesterday be effective for the businesses of tomorrow⁹⁵?

The OECD is working on possible solutions; their report with findings is due in September 2014. Five possible options will be analyzed in the report⁹⁶. These possible solutions will be analyzed to the principles of the electronic commerce taxation formulated in 1998. The goal is to make it easy to comply for taxpayers and to minimize the administrative burden. The new system also has to be flexible in order to adapt to new technologies from this digital economy. In their report the OECD will discuss five options to fight the challenges, which I mentioned above⁹⁷.

⁹⁴ Dr. Jean-Philippe Chetcuti, “The challenge of e-commerce to the definition of a permanent establishment: the OECD’s response”, lex e-scripta, (2002).

⁹⁵ Dr. Jean-Philippe Chetcuti, “The challenge of e-commerce to the definition of a permanent establishment: the OECD’s response”, lex e-scripta, (2002).

⁹⁶ Lyne M. Gaulin, “OECD base erosion and profit shifting action plan: action – addressing tax challenges of digital economy”, Toronto, (April, 2014)

⁹⁷ OECD, “BEPS action 1: address the tax challenges of the digital economy”, (24 March 2014).

The five options they will address are:

- To modify the exemptions from the permanent establishment
- To establish a new nexus rule to use for digital businesses in the digital economy
- To create rules for the new virtual permanent establishment
- To create a withholding tax on digital transactions
- To require non-resident vendors to collect VAT

These five options are also the options that I will discuss in the light of my research question:

What are the permanent establishment issues, regarding the taxation of the Bitcoin, and how can they be solved? Taking article five of the OECD model tax convention as the starting point.

7.3.1 Modify the exemptions from the permanent establishment.

The exemptions are mentioned in paragraph four of article five⁹⁸. This paragraph excludes some situations from being a permanent establishment⁹⁹. The exclusions are:

- a. The use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
- b. The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
- c. The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
- d. The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
- e. The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
- f. The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

This is an indicative list of activities that are generally considered to be auxiliary or preparatory.

The main question in this paragraph is whether the terms goods or merchandise in

⁹⁸ Lyne M. Gaulin, "OECD base erosion and profit shifting action plan: action – addressing tax challenges of digital economy", Toronto, (April, 2014)

⁹⁹ CFE Fiscal committee, "opinion statement fc 7/2014 of the CFE on the OECD discussion draft: addresses the tax challenges of the digital economy", (April, 2014).

subparagraphs 4a, b, and c apply to Bitcoins¹⁰⁰. The OECD has clarified these terms for the purpose of the exemptions mentioned in subparagraphs 4a, b, and c. With goods and merchandise was meant, tangible property that can be stored, displayed and delivered. That does not cover Bitcoins. They also say that activities carried on through servers would fall under the exemptions of paragraph 4¹⁰¹. But in my opinion these activities, nowadays, can be core activities instead of preparatory or auxiliary, and for this reason are able to constitute a permanent establishment. In order for the Bitcoin community to establish a permanent establishment the something has to change¹⁰². The terms preparatory or auxiliary, referring to paragraph 4, are outdated, and therefore need revision to make them comply with Bitcoin and other new e-commerce and cloud computing trends. Another option to change paragraph four regards the exceptions under a, b c, and d. these options can remain available with an extra criterion, being that the activity has to be characterized as preparatory or auxiliary, meaning that it can't be the core business of the company¹⁰³. Where the server functions out a core part of the business there should be a permanent establishment¹⁰⁴.

We can conclude that server activities can't be generalized into the terms preparatory and auxiliary anymore, they can have core business activities to nowadays¹⁰⁵. For example, online advertising can be preparatory or auxiliary but when the core business of an enterprise is advertising, for example an online advertising agency, it can be core business to and for this reason constitute a permanent establishment¹⁰⁶.

7.3.2 Establish a new nexus rule to use for digital businesses in the digital economy.

The Bitcoin community makes a lot of use from servers. When you look at article five, paragraph one it is clear that a server would satisfy to these rules and therefore would constitute a permanent establishment. However, looking at the exceptions of paragraph four, exceptions are

¹⁰⁰ Lyne M. Gaulin, *"OECD base erosion and profit shifting action plan: action – addressing tax challenges of digital economy"*, Toronto, April, 2014

¹⁰¹ Dr. Subhjit Basu, *Global perspectives on e-commerce taxation law*, (Ashgate, TJ international LTD, 2007), p. 123

¹⁰² OECD, "Interpretation and application of article 5 of the OECD model tax convention", (February 17, 2012).

¹⁰³ PWC, "OECD summarizes options for addressing the tax challenges of the digital economy", (26 March 2014).

¹⁰⁴ Dr. Subhjit Basu, *Global perspectives on e-commerce taxation law*, (Ashgate, TJ international LTD, 2007), p. 123

¹⁰⁵ OECD, "Interpretation and application of article 5 of the OECD model tax convention", (February 17, 2012).

¹⁰⁶ Dr. Jean-Philippe Chetcuti, "The challenge of e-commerce to the definition of a permanent establishment: the OECD's response", *lex e-scripta*, (2002).

listed on the permanent establishment¹⁰⁷. A facility is not a permanent establishment if it is solely used for purchasing, storing, displaying or delivering goods, collecting information or carrying on any other type of activity of a preparatory or auxiliary character. In my opinion it is possible to think of a server as a storage unit, without falling in one of the exceptions of paragraph four. This means that a new nexus rule should be established. The United States treasury, for example, takes the position that when you lease or use a computer server you normally don't constitute a permanent establishment, because then you have to see the server as a facility for storage and display. This is different when you own the server because you have control over that server. When a company doesn't sell goods or services but only information, the US treasury mentions that a server can be considered a warehouse, which is under the examples of a permanent establishment, and the exceptions do not apply. But when a server hosts a website this falls under storing and displaying¹⁰⁸. But a server does more than just hosting the website, it also operates the website and allows the connection between the website and its user. This would mean that a server could constitute a permanent establishment, meaning that the exceptions of paragraph four are not applicable here.

A server can possibly be seen as a dependent agent, as under article five, paragraph five. A dependent agent as being a person must be seen in the consideration that the OECD model tax convention was drafted in a time where the internet and e-commerce didn't even exist¹⁰⁹. The treasury of the United States rejects this view¹¹⁰. In my opinion this is not correct because by means of software a website can make contracts, this is the key criteria for a dependent agent, which in my opinion is fulfilled. A broader view of the term permanent establishment might be appropriate; especially now human presence is more and more replaced by the work of computers and servers.

This new nexus rule should contain rules that cover the digital economy. Companies involved in this economy should be able to have a permanent establishment in another jurisdiction if they maintain a significant digital presence in this other jurisdiction¹¹¹. But when do you have "significant" digital presence? To indicate this, there have to be some factors to measure this

¹⁰⁷ OECD, "Interpretation and application of article 5 of the OECD model tax convention", (February 17, 2012).

¹⁰⁸ Dr. Jean-Philippe Chetcuti, "The challenge of e-commerce to the definition of a permanent establishment: the OECD's response", *lex e-scripta*, (2002).

¹⁰⁹ OECD, "Interpretation and application of article 5 of the OECD model tax convention", February 17, (2012).

¹¹⁰ Dr. Jean-Philippe Chetcuti, "The challenge of e-commerce to the definition of a permanent establishment: the OECD's response", *lex e-scripta*, (2002).

¹¹¹ PWC, "OECD summarizes options for addressing the tax challenges of the digital economy", (March 2014).

significance¹¹². These factors are, the sales of digital goods and/or services that are widely used or consumed in that jurisdiction, another factor is the presence of a branch offering marketing, consultancy or other secondary services¹¹³. This new nexus rule should then be implemented in all existing treaties in order to be sure all states have the same rule to determine whether a permanent establishment is constituted or not¹¹⁴. The way to attribute profits to a permanent establishment should also be examined in the same way. In order to make Bitcoin qualify to have a permanent establishment in another jurisdiction, all requirements of something physical have to be eliminated. This approach focuses on the digital goods and services, and not on online sellers of tangible goods. For companies who are fully active in these dematerialized activities, the nexus will be the location of the customer, or where an enterprise uses personal data of customers in a country¹¹⁵. According to the OECD there are some potential elements for the new nexus rule to include. The core business should rely entirely in a part on digital goods or services. This means that no physical elements can be involved in the value chain, other than the use of servers and websites or any other IT tools. Contracts are concluded without interference of physical human work, so they should be concluded via the Internet or by telephone. Payments can only be made by payment systems using online forms or platforms. Also should the majority of the profits be attributable to the digital goods and services¹¹⁶.

When an enterprise is operating in this fully dematerialized business, a significant digital presence should be deemed in the following cases: when a significant number of contracts for the provision of fully dematerialized digital goods or services are signed. The digital goods and services should be widely used and consumed in the country. Also a significant presence is deemed when payments are made from clients in the country to the enterprise in connection with contractual obligations arising from the provision of digital goods or services as a part of the core business. When these options are fulfilled a substantial nexus can be concluded¹¹⁷.

7.3.3 Create rules for the new virtual permanent establishments.

New rules for the new virtual permanent establishments can be achieved through expanding or revising the current permanent establishment article. First, the virtual permanent establishment

¹¹² CFE Fiscal committee, "opinion statement fc 7/2014 of the CFE on the OECD discussion draft: addresses the tax challenges of the digital economy", (April, 2014).

¹¹³ Jessica Englert, "OECD releases digital economy discussion draft: few surprises-no conclusions", international tax, (April 3, 2014).

¹¹⁴ OECD, "BEPS action 1: address the tax challenges of the digital economy", (March 2014).

¹¹⁵ Jessica Englert, "OECD releases digital economy discussion draft: few surprises-no conclusions", international tax, (April 3, 2014).

¹¹⁶ Lyne M. Gaulin, "OECD base erosion and profit shifting action plan: action – addressing tax challenges of digital economy", Toronto, (April 2014)

¹¹⁷ OECD, "BEPS action 1: address the tax challenges of the digital economy", (March 24 2014). P.66.

can be included in the existing article, as we have seen above. Second, an alternative provision can be implemented in the OECD model tax convention just like is done with the special rule for sportsmen and artists in article 17 of the OECD model convention¹¹⁸.

Nowadays the definition for a permanent establishment is already broadened. In the normal definition of a PE means a fixed place of business through which the business of an enterprise is wholly or partly carried on. Normally we would speak of an independent part of the business. The activities have to be independent and profitable. The activities also have to be durable and tangible. This said a website or cloud can never constitute a PE, they are not tangible and can't operate independent without the support of a server.

Thanks to the broadening of the definition a server can nowadays be a PE if it meets the following requirements¹¹⁹:

- The server that hosts a website and its location have to be at the foreign enterprise's disposal, this means owned or leased and operated by the enterprise.
- The server has to be located in the taxing state.
- The core business has to be performed through the server without the need for human intervention.

When the company only buys webhosting services it would not constitute a permanent establishment, because then they don't have control over the location or the server. The server also has to perform core services, and not only preparing services¹²⁰. When these demands are met a server could constitute a permanent establishment. It is fairly easy to manipulate this, if you want to have a permanent establishment in a certain country, you have to own and place your servers in that particular country, and when you don't want to constitute a permanent establishment you have to make use of webhosting services. With the rules we now have a cloud can never constitute a permanent establishment. The definition for a cloud is: a model for enabling convenient, on demand network access to a shared pool of configurable computing resources that can be rapidly provisioned and released with minimal management effort or service provider interaction. Most countries have already rejected this concept¹²¹. However, the

¹¹⁸ Dale Pinto, *E-commerce and source-based income taxation*, (IBFD publications BV, Doctoral series ,Amsterdam, 2003), p. 195.

¹¹⁹ Dr. Jean-Philippe Chetcuti, "The challenge of e-commerce to the definition of a permanent establishment: the OECD's response", *lex e-scripta*, (2002).

¹²⁰ PWC, "OECD summarizes options for addressing the tax challenges of the digital economy", (March 26 2014).

¹²¹ Jessica Englert, "OECD releases digital economy discussion draft: few surprises-no conclusions", *international tax*, (April 3, 2014).

Bitcoin community makes a lot of use of these so-called clouds. For example, mining activities use a lot of computing power, in order to get this power miners form pools that mine through clouds. Therefore it is still easy for the Bitcoin community to shift their profits to tax havens.

Several options for alternative permanent establishments have been proposed over the last few years. The OECD considers three alternatives for the virtual permanent establishment¹²². The first option is; that a virtual fixed place of business can constitute a permanent establishment when the enterprise has a website on a server of another enterprise located in a jurisdiction, and it has to carry on a business through this website¹²³. Secondly, a virtual agency permanent establishment can be constituted under the same circumstances of a normal agency but now it should be located in the other jurisdiction through technology, instead of a physical person. Thirdly, an on site business presence permanent establishment can be constituted when the economic presence of a company within a jurisdiction in circumstances in which the foreign enterprise provides on-site services or other business interface at the customers location¹²⁴.

Some countries already go even further, for example France and Spain. In France the main rule is that a presence of a server alone will be auxiliary and for this reason does not constitute a permanent establishment, unless people are involved in the activity. A server performing a company's core activities on the other hand can qualify as a permanent establishment. In the opinion of France this is not enough, in 2013 they released a report that proposes a virtual permanent establishment approach, in which data uploaded by a consumer could by itself create a permanent establishment. But France isn't the only country having trouble with the definition. In 2012 a case came from the Spanish court regarding a Spanish subsidiary of the Dell computer group¹²⁵. This subsidiary constituted a permanent establishment for an Irish sales company of Dell products ltd. Last named company hosted a website outside of Spain, through which Spanish sales were made, although this company did not have any employees in Spain the court ruled that Dell products ltd. did have a permanent establishment in Spain¹²⁶.

In my opinion the best option would be to have an alternative permanent establishment standard in a new article of the OECD model tax convention. Just like article 17. The OECD has a few options for this new virtual permanent establishment definition as we have seen above.

¹²² CFE Fiscal committee, "opinion statement fc 7/2014 of the CFE on the OECD discussion draft: addresses the tax challenges of the digital economy", (April 2014).

¹²³ Lyne M. Gaulin, "OECD base erosion and profit shifting action plan: action – addressing tax challenges of digital economy", Toronto, (April 2014).

¹²⁴ OECD, "BEPS action 1: address the tax challenges of the digital economy", (March 24 2014).p.66

¹²⁵ Monica Gianni, "The OECD's flawed and dated approach to computer servers creating permanent establishments", Vanderbilt journal of entertainment and technology law, (2014), p31.

¹²⁶ Monica Gianni, "The OECD's flawed and dated approach to computer servers creating permanent establishments", Vanderbilt journal of entertainment and technology law, (2014), p31.

7.3.4 Impose a Withholding tax on digital transactions.

When transactions involve digital goods over the Internet we have to go back to the characterization of the Bitcoin, is the income generated business profit or royalties. As we have seen mostly Bitcoins are characterized as property or currency, this means that the income generated is business profit. This distinction is important because royalties are subject to a different tax regime than business profits.

Payments made by a resident of one country to purchase digital goods or services provided by a foreign e-commerce provider can be subject to withholding taxes¹²⁷. Although I can understand that the imposition of withholding taxes on a digital transaction can solve the problem that in many cases a company would not have a physical presence in the other state, this brings some complications, such as the identification of the customer and his state of residence for the determination for the withholding taxes¹²⁸. It is also unclear who should carry the burden of the payment: the customer or the provider of the service.

7.3.5 Require non-resident vendors to collect VAT.

First we need to know whether this is necessary in the Bitcoin community. When goods or services are supplied, it depends on the kind of transaction where the supply is taxed. There are three types of transactions in e-commerce¹²⁹:

1. Supplies of tangible goods to business or private consumers
2. Supplies of intangible goods and/or services to businesses
3. Supplies of intangible goods and/or services to private consumers

Bitcoins are intangible so the first option doesn't have to be taken into account.

Supplies of digital products are treated the same as supplies of services. The main rule is that these services are supplied where the customer is. When individuals receive supplies in their personal capacity they are taxed where they have their place of residence.

Companies are taxed in the country where they have the business that receives the digital goods. When the supplier and the customer have their residence in the same EU member state, the supplier is due to pay VAT. It becomes more difficult when they have their residence in different member states, than the reverse charge mechanism applies. This means that the supplier doesn't

¹²⁷ OECD, "BEPS action 1: address the tax challenges of the digital economy", (March 24 2014).

¹²⁸ PWC, "OECD summarizes options for addressing the tax challenges of the digital economy", (March 26 2014).

¹²⁹ The council of the European union, "council directive 2002/38/EC", (May 7, 2002).

have to pay the VAT in the other EU member state, regardless whether the customer has its residency in the EU or not. When the customer has his residency in another EU member state, he has to pay the VAT in that member state, due to the reverse charge mechanism. After this the customer can recover its input tax, depending on if he is making taxable supplies or not. In the situation that a non-EU supplier, supplies to a EU customer the reverse charge mechanism applies¹³⁰. This regime creates a level playing field between all suppliers.

The main rule for the taxation of private customers is, that the supply is taxed where the supplier has his company. When a supplier makes electronic supplies to a customer within the EU with its residency outside of the EU, the supply is taxed in the country of the EU customer. When the supplier has his business in the EU, and the supply is in another member state of the EU, VAT will be de in the member state of the supplier. The use and enjoyment provision does not apply here¹³¹. This means that suppliers from outside the EU supplies to a private customer within the EU has to pay the VAT in the EU member state and therefore has to register in that member state.

Technological advancements could also assist tax administrations to simplify the registration and compliance mechanisms for VAT collection, making it more feasible to require a non-resident supplier of low value goods or other cross border transactions to charge, collect and remit VAT¹³². Enforcing compliance from non-resident suppliers will be challenging for tax administrations, but it may be improved through expanded mutual assistance and exchange of information agreements between taxing jurisdictions¹³³.

7.4 Analysis.

After this it still seems debatable whether the problems are solved. The OECD's clarification and the options they recommend have helped, but it probably isn't enough. Servers that hold Bitcoin (information) are very mobile. This is because servers do not need geographic presence in any country. Therefore companies operating in the Bitcoin community can have servers all over the world. Activities operated through these servers can be located in any way the company wants them to, the companies can in this way manipulate where they have a permanent establishment, in this way they can ensure their business profits are only taxed in tax havens or other low tax jurisdictions.

¹³⁰ The council of the European union, "council directive 2002/38/EC", (May 7, 2002).

¹³¹ <http://www.hmrc.gov.uk/manuals/vatpossmanual/VATPOSS13550.htm>

¹³² CFE Fiscal committee, "opinion statement fc 7/2014 of the CFE on the OECD discussion draft: addresses the tax challenges of the digital economy", (April, 2014).

¹³³ Joseph D. Poole, "Taxing Digital transactions and virtual goods", pierce law group, (august 8, 2012).

The OECD ignores some vital issues, for instance the fact that e-commerce functions are being transferred to the computer of the end user. Servers can transfer software and Bitcoins through the Internet to the computer of the end user. Bitcoin operates through a peer-to-peer network where Bitcoin transaction, and mining activities take place. Because they operate via a peer-to-peer network they don't operate through one server but instead they use multiple servers. This makes it almost impossible to determine the location of the permanent establishment. This networking technology has made it very lucrative to relocate servers across borders in order to save tax money.

Another option to circumvent the rules of a permanent establishment is by carrying on just preparatory or auxiliary activities in a source state and placing servers in a low or no tax jurisdiction in order to create a permanent establishment.

7.5 Conclusion.

Now that a physical presence is no longer needed due to the digital economy, the rules based on physical presence are outdated. For this reason taxation, in the market country can be minimized, by avoiding a taxable presence in that country. Or by shifting profits through structures that minimize tax liability. We have seen that a permanent establishment means a fixed place of business through which the business of an enterprise is wholly or partly carried on. The main problem is found in the term fixed, which is as said no longer needed. The OECD is working on five possible solutions.

- To modify the exemptions from the permanent establishment
- To establish a new nexus rule to use for digital businesses in the digital economy
- To create rules for the new virtual permanent establishment
- To create a withholding tax on digital transactions
- To require non-resident vendors to collect VAT

The first option is to modify the exemptions from the permanent establishment. The exemptions a considered to be auxiliary or preparatory, we concluded that server activities cant be generalized into the terms preparatory or auxiliary anymore, servers can have core businesses nowadays.

The second option is to establish a new nexus rule to use for digital businesses in the digital economy. Looking at article five paragraph one a server would be able to constitute a permanent establishment, but gets exempted in paragraph four. A possible solution for this may be that a server can be seen as a dependent agent, as in paragraph five of article five. The new nexus rule should contain rules covering the digital economy, so that companies can have a permanent establishment in another jurisdiction if they maintain a significant **digital** presence in that other jurisdiction.

The third option is to create rules for the new permanent establishment. Expanding or revising the current permanent establishment article can achieve this. The definition of a permanent establishment is already broadened; a server can now constitute a permanent establishment if it meets the requirements. The OECD considers three possible alternative rules. Some countries already are making new rules themselves for the permanent establishment; France and Spain are already doing this. I think it is best to create a new article for the virtual permanent establishment.

The fourth option is to create a withholding tax on digital transactions. Income from Bitcoin is business profit. Payments made by a resident of one country to purchase digital goods or services provided by a foreign e-commerce provider can be subject to withholding taxes. However this brings in my opinion to many complications, such as the identification of the customer and his state of residency. It is also unclear who should carry the burden.

The fifth option is to require non-residents to collect VAT. Regarding Bitcoin two types of transactions are important, first supplies of intangible goods and/or services to businesses, and second supplies of intangible goods and/or services to private consumers. The main rule is that these services are supplied where the customer is. When individuals receive supplies in their personal capacity they are taxed where they have their place of residence. The main rule for companies is that they are taxed in the country where they have the business that receives the digital goods. There are exceptions for example when the supplier isn't from another EU member state. The main rule for the taxation of private customers is, that the supply is taxed where the supplier has his company. This rule has exceptions to. Technological advancements could also assist tax administrations to simplify the registration and compliance mechanisms for VAT collection, making it more feasible to require a non-resident supplier of low value goods or other cross border transactions to charge, collect and remit VAT.

After this it still seems debatable whether the problems are solved. The OECD's clarification and the options they recommend have helped, but it probably isn't enough. The OECD ignores some vital issues. Because they operate via a peer-to-peer network they don't operate through one server but instead they use multiple servers. This makes it almost impossible to determine the location of the permanent establishment.

8.1 Introduction.

In chapter seven possible solutions for the issues with Bitcoin and permanent establishment are mentioned. We have concluded that the issues regarding Bitcoin won't all be solved with these solutions, but a part of the issues will be solved. Therefore it is time for the next step: How should income be attributable to software functions within servers? Is this profit attributable to the server or maybe even to the website? For the companies that do constitute a permanent establishment under article 5 OECD the next question will be how to attribute the income derived from their Bitcoin profits¹³⁴. Attribution of profits to permanent establishments has been an issue for many years within the context of international taxation¹³⁵.

8.2 Article 7 OECD model tax convention.

What are the rules regarding the attribution of profits to a permanent establishment? These rules can be found in article 7 of the OECD model tax convention. This article states¹³⁶:

Article 7

Business profits

1. Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.
2. For the purposes of this Article and Article [23 A] [23B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions

¹³⁴ OECD, "Report on the attribution of profits to permanent establishments", (December 2006). P.2.

¹³⁵ OECD, "Attribution of profit to a permanent establishment involved in electronic commerce transactions", (February 2001). P. 6.

¹³⁶ OECD, "Articles of the OECD model tax convention on income and capital", (July 22, 2010).

performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.

3. Where, in accordance with paragraph 2, a Contracting State adjusts the profits that are attributable to a permanent establishment of an enterprise of one of the Contracting States and taxes accordingly profits of the enterprise that have been charged to tax in the other State, the other State shall, to the extent necessary to eliminate double taxation on these profits, make an appropriate adjustment to the amount of the tax charged on those profits. In determining such adjustment, the competent authorities of the Contracting States shall if necessary consult each other.
4. Where profits include items of income, which are dealt with separately in other Articles of this Convention, then the provisions of this Article shall not affect the provisions of those Articles.

8.2.1 Paragraph one.

Looking at paragraph one, two interpretations are widely used, to determine the profits of a permanent establishment, by member states. These interpretations are the functional separate entity approach and the relevant business activity approach. The risk of two approaches to be widely used is the risk of double taxation or double non taxation, in the cases that one member states uses the functional separate entity approach and the other member state the relevant business activity approach¹³⁷. The functional separate entity approach however is the preferred interpretation of paragraph one (Authorized OECD approach)¹³⁸. According to this approach the permanent establishment is treated as if it was a separate enterprise, performing the same or similar functions under the same or similar conditions, determined by applying the arm's length principle of paragraph 2 of article 7 of the OECD model convention, this is in line with the arm's length principle¹³⁹.

8.2.2 Paragraph two.

Paragraph two is the most important paragraph of this article, this paragraph mentions that the arm's length principle has to be used to attribute profits to the permanent establishment.

¹³⁷ Monica Gianni, "The OECD's flawed and dated approach to computer servers creating permanent establishments", *Vanderbilt journal of entertainment and technology law*, (2014), p16.

¹³⁸ OECD, "Report on the attribution of profits to permanent establishments", (December 2006). P.12.

¹³⁹ OECD, "Attribution of profit to a permanent establishment involved in electronic commerce transactions", (February 2001). P.7.

According to the OECD commentary the interpretation of this paragraph has to be divided into two steps¹⁴⁰:

1. A functional and factual analysis
2. Determine, using the OECD transfer pricing rules, the appropriate compensation to be attributed to the permanent establishment if it were a separate enterprise

Using the functional and factual analysis we can find which significant activities are done by the whole enterprise, including the permanent establishment. Having this clear the enterprise can be divided, and can be determined which of the activities are associated with the permanent establishment and to what extent¹⁴¹. In this analysis the used assets and taken risk have to be taken into account, as long as they can be accounted to the permanent establishment¹⁴².

The second step is to determine the appropriate profit that can be attributed to the permanent establishment. For this step we need to use the OECD transfer pricing rules to determine the profit that can be allocated to the permanent establishment. We have to look at the permanent establishment as if it were a separate legal entity¹⁴³.

The transfer pricing guidelines contain for transfer pricing methods, which will be described briefly in order to understand what they do. The five methods are:

- The CUP method
- The resale price method
- The cost plus method
- The transactional net margin method
- The transactional profit split method

CUP method stands for comparable uncontrolled price method. In this method the price is compared in the situation between enterprises, and the same situation only with a third party¹⁴⁴. When the outcome differs, so for example when third parties are charged a higher price, adjustments can be made to eliminate this. For a company selling Bitcoins this can be a good option because the quality of a Bitcoin is always the same.

¹⁴⁰ OECD, "Attribution of profit to a permanent establishment involved in electronic commerce transactions", (February 2001). P.8.

¹⁴¹ OECD, "Report on the attribution of profits to permanent establishments", (December 2006). P.12.

¹⁴² Monica Gianni, "The OECD's flawed and dated approach to computer servers creating permanent establishments", *Vanderbilt journal of entertainment and technology law*, (2014), p17.

¹⁴³ OECD, "Report on the attribution of profits to permanent establishments", (December 2006). P.13.

¹⁴⁴ OECD, "Transfer pricing methods", (July 2010), p.2.

In the resale price method, the starting point is the price for which the product is obtained from an associated company and the sold to a third party. This price has to be reduced by an appropriate gross margin. So this is the resale price margin, the amount that the reseller earned. It has to be internally and externally comparable. This method is mostly used by marketing services¹⁴⁵.

With the cost plus method we start with the costs that the supplier has to make in order to sell his product. Using this method the mark-up on costs that the manufacturer or service provider earns is compared with the mark-up on costs from a comparable uncontrolled transaction. This method can best be used when the provider adds not a lot of value to the product or service¹⁴⁶.

The transactional net margin method, examines the net margin from controlled and uncontrolled situations instead of comparing the gross profit or gross mark up on costs as we have seen in the methods before¹⁴⁷.

In the transactional profit split method, is more complicated. First the combined profits to be split have to be identified, for the associated companies from the controlled transactions in which the associated companies are involved. After this the combined profits will be split between the associated companies on an economically valid basis that approximates the division of profits that would have been anticipated between independent companies¹⁴⁸.

The choice of a transfer pricing method should always be aimed at finding the best option in particular cases¹⁴⁹. Not all methods can be used in all cases. For the selection of an appropriate method, the strengths and weaknesses of the methods should be measured, the availability of information should be accounted as well. As possible the comparability of the controlled and uncontrolled situation should count.

8.2.3 Paragraph three and four.

Paragraph three defines that a Contracting State adjusts the profits that are attributable to a permanent establishment when the criteria of transfer pricing are not met¹⁵⁰. Paragraph four excludes profits that are dealt with in other articles¹⁵¹.

¹⁴⁵ OECD, "Transfer pricing methods", (July 2010), p.4.

¹⁴⁶ OECD, "Transfer pricing methods", (July 2010), p.5.

¹⁴⁷ OECD, "Transfer pricing methods", (July 2010), p.6.

¹⁴⁸ OECD, "Transfer pricing methods", (July 2010), p.8.

¹⁴⁹ OECD, "Transfer pricing methods", (July 2010), p.9.

¹⁵⁰ OECD, "Attribution of profit to a permanent establishment involved in electronic commerce transactions", (February 2001). P.11.

8.3 characterization of a server that constituted a permanent establishment

We can take for example a server that constituted, according to article 5 of the OECD model tax convention, a permanent establishment in a source country. This server does not have any personnel located in this source country. The server is programmed to buy and sell Bitcoins, and to process every step of these transactions. The personnel of the mother company have written the software used on that is used on the server.

The first step that needs to be made, in the analysis of which amount of profit is attributable to the server is to see the server as a separate entity of the company. After this the activities of the server, the risk taken, and the assets used by the permanent establishment have to be identified. This can be done by a functional analysis of the activities of the server. The assets used are the tangible server, and the intangible software that is programmed on the server. There are also risks that should be taken into account, for example: the credit risk, the market risk, and the technological risks. Concluded can be that the server sets up contracts with the clients.

After this functional analysis there has to be determined which of the transfer pricing methods fit best in these circumstances¹⁵². The only thing the server does is make contracts and the following transaction; this means it doesn't add much value to the Bitcoin. Concluded can be is that the profit of the server won't be very high. Looking at the CUP method there have to be compared with a comparable situation, probably the software written for this server is one of a kind, therefore this method won't do any good. The transactional net margin method can be used when it is not possible to apply a traditional method reliably. According to this information the cost plus method suits best in this situation, because there is nothing added to the product, only contracts are made and transactions are executed. A reasonable price should be added to the cost of the Bitcoin¹⁵³.

As noticed before the Bitcoin community operates through a peer-to-peer network. In a peer-to-peer network the peers are computer systems that are connected with each other through the Internet. Bitcoins can be shared directly between the systems without the need of a central server. This makes things a lot harder to determine. Especially the determination of a permanent establishment brings problems, because the network uses different computer systems every

¹⁵¹ OECD, "Report on the attribution of profits to permanent establishments", (December 2006). P.72.

¹⁵² OECD, "Report on the attribution of profits to permanent establishments", (December 2006). P.14.

¹⁵³ Monica Gianni, "The OECD's flawed and dated approach to computer servers creating permanent establishments", Vanderbilt journal of entertainment and technology law, (2014), p21.

time, the geographical presence can't be determined. This means no permanent establishment can be constituted. When under the new rules a permanent establishment can be constituted the main relevant difference is that the functions that is the previous example that was performed by one server, now is done by multiple servers. The volume of the transactions now is shared among the servers all over the world, the fact that there are now multiple servers doing the same thing reduces the risks¹⁵⁴. The determination of the transfer pricing stays the same.

At this moment it is not possible to attribute profits to a website, this is because in most countries it is impossible to constitute a permanent establishment through a website¹⁵⁵. With the development of the laws domestically as well as international it seems only a matter of time before a permanent establishment can be constituted through a website. When this is possible, in order to be able to attribute income to the website the same steps need to be taken as done above.

8.4 Conclusion.

In this chapter the attribution of income to a permanent establishment was the main focus. Attribution of profits to permanent establishments has been an issue for many years within the context of international taxation. The rules of income attribution to these permanent establishments can be found in article 7 of the OECD model tax convention. Looking at paragraph one, two interpretations are widely used, to determine the profits of a permanent establishment, by member states. These interpretations are the functional separate entity approach and the relevant business activity approach. The functional separate entity approach however is the preferred interpretation of paragraph one (Authorized OECD approach).

Paragraph two mentions that the arm's length principle has to be used to attribute profits to the permanent establishment, this has to be divided in two steps. A functional and factual analysis is the first step. Determining the appropriate compensation to be attributed to the permanent establishment as if it were a separate enterprise is the second step that needs to be taken.

There are five transfer pricing methods:

- The CUP method
- The resale price method

¹⁵⁴ OECD, "Report on the attribution of profits to permanent establishments", (December 2006). P.15.

¹⁵⁵ OECD, "Report on the attribution of profits to permanent establishments", (December 2006). P.12.

¹⁵⁵ Monica Gianni, "The OECD's flawed and dated approach to computer servers creating permanent establishments", Vanderbilt journal of entertainment and technology law, (2014), p22.

- The cost plus method
- The transactional net margin method
- The transactional profit split method

The choice of a transfer pricing method should always be aimed at finding the best option in particular cases. Not all methods can be used in all cases. Paragraph three defines that a Contracting State adjusts the profits that are attributable to a permanent establishment when the criteria of transfer pricing are not met. Paragraph four excludes profits that are dealt with in other articles.

Chapter nine

9.1 Conclusion

In the last years we have seen the development of virtual economies. There are three different types of digital economies in which virtual currencies can be used: the closed economy, the hybrid economy, and the open economy. The focus in this master thesis was on the open economy because this is the only economy where operate in. Bitcoins come into circulation through mining operations, and then get stored in wallets. When a purchase is made with Bitcoins the transaction has to be validated and stored in the permanent record. After this the transaction is completed and the Bitcoins have moved to the sellers account.

Products and services can be provided to buyers in new manners since the development of the digital economy. These new ways raise questions how to characterize this income derived from these new business models. This categorization is important in the light of existing categorization of income and for the consistency of treatment of similar types of transactions. Bitcoins can be characterized as currency, private money, property, and as vouchers. It is important to characterize Bitcoins because most taxpayers know that there may be a tax liability, but they don't know the right way to treat them for tax purposes. All characterizations have their own pros and cons. The best ways to characterize Bitcoins in my opinion is as property or as currency. When Bitcoins are taxed as property they will be taxed with capital gains tax, the main advantage of this tax treatment is that the capital gains tax is lower than the normal income tax; the most important con is the fact that users will have to keep track of every Bitcoin they have bought and sold. When Bitcoins are characterized as currency they will be subject to normal income tax, as we have seen the income tax rate with this characterization is higher, but users don't have to keep track of their Bitcoins.

A difficult issue in taxation of the Bitcoin is the calculation of the tax liability. This is because taxes have to be paid over income derived from Bitcoin, but no governments accept payments in Bitcoin. When Bitcoins are treated as property users have to keep track of all their Bitcoins and know what they were worth at the moment when they bought them and at the moment they were sold, after this taxes have to be paid on another moment over this raise in value. This means that the value that has to be collected for sales tax due on the transaction can be a lot different from the time of remittance to the taxing agency.

Bitcoins are made illegal in a few countries, but in most countries Bitcoins are legal. Most countries define Bitcoins as property and some as currency. But I reckon most countries will switch their tax treatment to currency when Bitcoin gets more widely adopted.

Now we have seen that our focus is in the open economy, and that we have seen how Bitcoins can be characterized. Now we know enough about the domestic situations, this was important in order to have clear before we could get to the international aspects. The first thing that was needed was to classify the different actors in the Bitcoin process. According to the finCEN there are three actors possible: users, administrators and exchangers. A user can never be a MSB the other two actors can under circumstances be qualified as a MSB. In the Bitcoin world we have miners as a possible actor. According to the finCEN, an individual or a company that uses Bitcoins they mined themselves, for their own benefit, and the company has neither accepted nor transmitted and for this reason does not entail a money transmission. Virtual currency developers are another important actor. For these developers also counts that they not trade in Bitcoins they will not be seen as an MSB. The last important actor of Bitcoins are the investors as long as they are investing on behalf of itself they will also not be an MSB.

The transactions made in and with Bitcoins are mostly operated through the software as a service model, which operates through the cloud. The consumer of the service hereby usually doesn't manage or control the cloud infrastructure needed to provide the service. This control is needed under the current rules to establish a permanent establishment.

In order to be taxable you need to be a resident or have a permanent establishment in the other country, domestic laws of each country determine whether a person is a resident or not. The concept of being a resident of a contracting state has multiple functions and is important for resolving situations where double taxation can occur. Generally speaking domestic laws of both states impose tax liabilities based on person's attachment to the state of residence. This liability isn't only imposed on residents of that contracting state but also on persons who stay in the

territory of that state. From this double taxation issues can occur. This is the moment where tax treaties come into place. The OECD model tax convention determines that *any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof*, is a resident. When the company does transactions with other countries, the taxing rights are given to that other country. With the rise of the digital economy it isn't sure that the other country will tax, because there is no permanent establishment in that other country. These issues arise from the fact that domestic and international rules were established before the digital economy even existed, for this reason the rules are based on the outdated principle of a physical nexus in the taxing jurisdiction.

Nowadays multinationals have much more possibilities, for example doing business through a website. For this reason taxation, in the market country can be minimized, by avoiding a taxable presence in that country. We have seen that a permanent establishment means a fixed place of business through which the business of an enterprise is wholly or partly carried on. The main problem is found in the term fixed, which is as said no longer needed. The OECD is working on five possible solutions.

- To modify the exemptions from the permanent establishment
- To establish a new nexus rule to use for digital businesses in the digital economy
- To create rules for the new virtual permanent establishment
- To create a withholding tax on digital transactions
- To require non-resident vendors to collect VAT

After this it still seems debatable whether the problems are solved. The OECD's clarification and the options they recommend have helped, but it probably isn't enough. The OECD ignores some vital issues. Because they operate via a peer-to-peer network they don't operate through one server but instead they use multiple servers. This makes it almost impossible to determine the location of the permanent establishment.

Attribution of profits to permanent establishments has been an issue for many years within the context of international taxation. The rules of income attribution to these permanent establishments can be found in article 7 of the OECD model tax convention. Looking at paragraph one, two interpretations are widely used, to determine the profits of a permanent establishment, by member states. These interpretations are the functional separate entity

approach and the relevant business activity approach. The functional separate entity approach however is the preferred interpretation of paragraph one (Authorized OECD approach).

Paragraph two mentions that the arm's length principle has to be used to attribute profits to the permanent establishment, this has to be divided in two steps. A functional and factual analysis is the first step. Determining the appropriate compensation to be attributed to the permanent establishment as if it were a separate enterprise is the second step that needs to be taken.

There are five transfer-pricing methods:

- The CUP method
- The resale price method
- The cost plus method
- The transactional net margin method
- The transactional profit split method

The choice of a transfer pricing method should always be aimed at finding the best option in particular cases. Not all methods can be used in all cases. Paragraph three defines that a Contracting State adjusts the profits that are attributable to a permanent establishment when the criteria of transfer pricing are not met. Paragraph four excludes profits that are dealt with in other articles.

9.2 Answer of the research question.

In order to understand what Bitcoins are and how they get taxed we first had to know the domestic situation. After this we could investigate the international situation and find out the answer to this master thesis:

What are the permanent establishment issues, regarding the taxation of the Bitcoin, and how can they be solved?

The question was already answered throughout the thesis, but I will answer it briefly again. In order to be taxable in a country there either has to be a resident according to article 4 OECD model tax convention, or a permanent establishment according to article 5 of the OECD model tax convention. As we have seen the issues start with the fact that the rules for permanent establishments were drafted before the digital economy and virtual currency, and therefore are now outdated. With the rise of the digital economy and virtual currency, new business models

came available to reach customers without having a physical presence in the country of that customer. The home country will then give the taxing rights to the other country, but that country sees no physical presence, and therefore can't tax the company. Double non-taxation is the result. This is what tax treaties try to prevent. Therefore the OECD is trying to solve these problems. The OECD is working on five possible solutions.

- To modify the exemptions from the permanent establishment
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Chapter ten

10.1 Recommendations.

Here I will share my opinion what has to happen with income from Bitcoins, and with the issues with the permanent establishment. In these recommendations I will first discuss the different types of tax applicable that are applicable to the Bitcoin, in this paragraph I will also share my opinion on how the different actors should be taxed. After this I will give my opinion on how the issues regarding the Bitcoin and permanent establishment should be solved.

10.2 VAT treatment of Bitcoin and its actors.

The VAT system should contain new rules solving the existing problems that occur, furthermore it should be clear in order to ensure legal certainty. In my opinion the new rules should be implemented in the EU VAT directive because this system is consistent and created to be implemented in multiple countries.

Bitcoin miners are not an economic activity for VAT purposes because there isn't a sufficient link between the service and the amount received. Therefore mining Bitcoins should be out of scope of VAT.

However when there is a sufficient link between the service and the amount received they should be exempted because they fall under article 135 paragraph 1 under d of the VAT directive which states: "Member states shall exempt the following transactions: transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection". This should only be the case when they actually fall in the definition stated above. When Bitcoins are changed back for government-backed currencies, no VAT should be due over the value.

However VAT should be paid, when goods and/or services are sold for Bitcoins. The value of the supply of goods and/or services should be the economic value of the Bitcoin at the moment of delivery.

10.3 Other types of taxes.

All other types of activity that are not mentioned above are subject to corporate income tax, income tax, or capital gains tax. Whether a profit or gain is taxable with either one of these taxes should be examined case by case.

Businesses accepting Bitcoin for their goods and/or services should see no change in the way their profit is calculated and taxed. For corporate income tax the profits and losses will be taxable when the Bitcoins are exchanged to government-backed currency. In this case the rules for exchange and loan relationships should be applicable. Also profits and losses regarding Bitcoin transaction can be treated under the existing corporate income tax rules.

The profits and losses made by people, not constituting a business, Bitcoins are a part of their income and therefore should also be treated as income, and fall under the income tax rules.

In situations not mentioned above Bitcoins should be, for individuals taxable for capital gains tax, and for businesses they should be taxable for corporate income tax.

10.4 Issues regarding the permanent establishment.

The best way to solve the problems regarding the permanent establishment in my opinion is to create a new rule for the “virtual permanent establishment”, which should be implemented as a new article in the OECD model tax convention just like the rule in article 17 of the OECD model tax convention for sportsmen and artists. This new rule should not adhere the rules of sufficient physical presence in the other state, but they should test whether there is enough virtual presence in that other state.

10.5 Issues regarding the profit attribution to permanent establishments.

To solve the issues regarding the profit attribution to permanent establishments, the rules of article 7 of the OECD model tax convention have to be changed. Looking at paragraph one we see that two different types of interpretations are widely used, to determine the profits of a permanent establishment, by member states. These interpretations are the functional separate entity approach and the relevant business activity approach. The outcome of both

interpretations can be different, and therefore create legal uncertainty. The functional separate entity approach already is the preferred interpretation of paragraph one (Authorized OECD approach). This approach should be the only approach possible, with this legal certainty prevails and double taxation and double non-taxation are avoided.

In paragraph two the functional and factual analyses have to be used. It can be hard to determine functional and factual, what income to attribute to the permanent establishment but these ways don't constitute any big problems, it will always be a case to case factual analyses whether or not an income can be attributed to the permanent establishment or not.

The determination of the transfer pricing method brings more difficulties. Clear rules should be made when to use what method. Another option could be to rank the transfer pricing methods, then businesses can start with the option ranked first, and if that doesn't fit they can move on to the next method.

10.6 Legal principles.

Solving the problems involves implementing new taxing rules; these new rules should be neutral and equitable between the different types of e-commerce. Taxpayers that can be compared should be treated the same, their tax burden should be the same.

It is also important that the new rules are efficient; the tax burden on taxpayers and administrators should be kept as low as possible. The rules should also bring legal certainty and simple, in order for everyone to understand them. If taxpayers can easily understand the new rules, it makes it easier for them to comply. Above all, the new rules should be as effective and fair as possible, they should produce the right amount of tax at the right time, and not create possibilities to avoid taxation.

In order to keep pace with the rapid evolution of the taxation system, the new rules should also be dynamic and flexible to keep pace with new developments in contrary to the old rules.

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