Permanent Establishment: A New Identity In The Context Of The Digital Economy

HAMDADAOU Ouahiba

University of Oran 2, Algeria, ouadah.ouahiba2023@gmail.com

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Abstract:

The concept of a permanent establishment (PE) is a cornerstone of international taxation, codified in Article 5 of the OECD and UN Model Tax Conventions. It determines the taxing jurisdiction for a company carrying out business activities outside its head office. At the same time, it protects multinational enterprises against double taxation by the states of residence and source. Commentaries on this concept are frequently updated, reflecting debates on its evolution in the face of the challenges posed by the digital revolution.

Keywords: *PE – Foreign companies; permanent establishment; digital economy ; Organisation for Economic Co-operation and Development ; United Nations.*

*** Corresponding author HAMDADAOU Ouahiba, e-mail: authorC@mail.com.**

Introduction:

The concept of permanent establishment is fundamental to international taxation in international taxation. This concept is currently set out in Article 5 of both the OECD and UN model tax conventions. It aims to determine the taxing jurisdiction for business activities carried out by an enterprise in a State other than that in which its head office is situated. It also protect companies operating in multiple jurisdictions from attempts by the State of residence and the source or host States to tax a company operating in multiple States simultaneously. The relevant commentaries are regularly amended, reflecting the ongoing debate surrounding the evolution of this concept, particularly in light of the digital revolution.

However, the development of digital commerce[1] has disrupted the legal foundations on which conventional and traditional rules regarding the taxation of profits were based, particularly those relating to the qualification of a permanent establishment. (Zahra, 2013) The OECD Committee on Fiscal Affairs has, in this regard, recognised the challenges posed by the development of the digital economy in relation to traditional rules governing permanent establishments.

The Committee has proposed that the entire international system must be reassessed. The aim of this proposal is to analyse the capacity of the current international tax framework to respond to developments arising from the digital economy, and in particular the impact of electronic commerce on traditional taxation.

Thus, the main issue facing us today is the difficulty in applying traditional tax principles—particularly the concept of a permanent establishment—to tax profits derived from electronic commerce, namely the physical absence of the business. (MEUROU, 2002, pp. 38–42) However, today, a company no longer needs to have a physical presence in a country to generate value and make a profit. (ROUSSIERE, 2009) This is why the concept of a permanent establishment will evolve to adapt to the market economy and the digital economy.

Under this new concept of a 'digital permanent establishment', profits would no longer be subject to corporation tax at the supplier's location, but rather at the location of the user or consumer, since the latter is a necessary condition for the generation of profits and reflects, in particular, the margin generated by network effects (location of significant digital presence). (ROUSSIERE, 2009)

In this regard, the Committee on Fiscal Affairs has suggested that several concepts and rules should be adapted or even modified to account for

the specific features of electronic commerce as part of a strategy to tax this type of transaction, and that the commentary on Article 5 of the OECD Model Tax Convention should be updated, in order to ensure tax fairness, avoid double taxation[2] and tax evasion[3].

This difficulty in resolving the issue of permanent establishment in the context of electronic commerce has led to the establishment of a technical advisory group within the OECD to examine, in particular, whether the definition of permanent establishment in the context of electronic commerce should be amended, or even simply abandoned.

The Committee on Fiscal Affairs of the Organisation for Economic Co-operation and Development has, in this regard, planned a draft update on 'permanent establishment' for 2019, entitled 'Addressing the tax challenges posed by the digitalisation of the economy', in which reference is made for the first time to a 'significant digital presence', or even "a virtual permanent establishment".

Our study will be presented along the following two main lines:

1- Proposals to replace the concept of permanent establishment

2- The digital economy in Algerian domestic law

1- Proposals to replace the concept of permanent establishment

Having examined certain clarifications and amendments introduced by the OECD and UN model tax conventions, these bodies have recognised that the tax challenges of the digital economy cannot be resolved simply by modifying the current definition of a permanent establishment. Indeed, these models propose that the entire international system must be reassessed. The aim of this proposal is to analyse the capacity of the current international tax framework to respond to developments arising from the digital economy, and in particular the impact of electronic commerce on traditional taxation.

Thus, the main issue facing us today is the difficulty in applying traditional tax principles—notably the concept of a permanent establishment—to tax profits derived from electronic commerce, due to the physical absence of the business. (MEUROU, 2002, pp. 38–42).

With this in mind, we will first analyse the challenges posed by international taxation in the face of economic digitalisation and the work undertaken to resolve them. A reworking of the nexus criteria in a borderless economy is necessary (1).

Next, we will address the impact of the digital economy on taxation in Algeria (2).

a- review of the nexus criteria in a borderless economy

The main challenge in a digital economy concerns, in particular, the loss of revenue from corporate income tax on multinational companies, as the international rules currently in force within the OECD do not allow for the satisfactory attribution of profits to companies established abroad on the basis of the revenue they generate in another territory. (MARIN, 2012)

Thus, the main issue facing us today is the difficulty in applying traditional tax principles—particularly the concept of a permanent establishment—to tax profits derived from electronic commerce, due to the physical absence of the company.

Similarly, when a company established in one state carries out all or part of its business in another state through a permanent establishment, it becomes liable to tax in that other state on the profits generated by its local operations. The criterion for a permanent establishment, as defined by model tax conventions, is very concrete and physical (dependent sales agent, fixed place of business, etc.). However, today, a company no longer needs to have a physical presence in a country to generate value and make a profit. (ROUSSIERE, 2009) This is why the concept of a permanent establishment will evolve to adapt to the market economy and the digital economy.

b- The concept of a virtual permanent establishment: 'significant digital presence'

Given that the concept of a permanent establishment is ill-suited to digital commerce, it has been proposed to replace it with another concept that is not linked to the physical presence of the foreign enterprise in a given state. Indeed, the concept of a "digital permanent establishment", designed to characterise all enterprises that carry out their "entirely digitized economic activity" as their principal activity via a virtual platform known as a "significant digital presence". (ARABI, 2021, p. 993)

Indeed, even in the absence of physical and human resources within that territory, if a company derives income from the operation of such a platform, it will consequently be subject to tax in that State. (KHOURI-HELOU, 2014, p. 2)

This is one of the proposals being examined by the OECD Task Force on the creation of a new tax nexus to address situations where certain economic activities carried out are entirely digital[3]. Provided that the following conditions are met:

- The company's core activities are entirely or largely dependent on digital goods or services;
- No physical elements or activities are involved in the creation of the goods or services or in their delivery, apart from the existence, use or maintenance of

servers and websites, or other IT tools, as well as the collection, processing and marketing of geolocated data;

- Contracts are generally concluded remotely via the internet or by telephone;
- Payments are made exclusively by credit card or other electronic means of payment, using online forms or platforms linked to or integrated into the relevant websites; Websites are the sole channel used to engage with the company; no physical shop or branch is involved in carrying out core activities, with the exception of offices located in countries where the parent company or operating company is established;
- Profits are entirely or predominantly attributable to the supply of digital goods or services; The seller's legal or tax residence and physical location are not taken into account by the customer and do not influence their choices;

The actual use of the digital good or the provision of the digital service does not require a physical presence or the involvement of any physical product other than the use of a computer, mobile devices or other IT tools". (OECD, 2015, p. 158)

Similarly, a French bill aimed at taxing income derived from a 'significant digital presence' in France was tabled on 6 March 2019 in the National Assembly. (Blandine, 2019)

This text proposes to establish rules extending the concept of a permanent establishment, as it applies to corporate income tax, to include the concept of a 'significant digital presence' as a criterion for determining a permanent establishment.

With this new concept of a "digital permanent establishment", profits would no longer be subject to corporation tax at the supplier's place of business, but rather taxed at the user's or consumer's location, since the latter is a necessary condition for the generation of profits and reflects, in particular, the margin generated by network effects (place of significant digital presence). (ROUSSIERE, 2009)

Similarly, the concept of 'significant presence' would be defined by three new criteria enabling a tax nexus to be established between companies providing digital services and the territory where value is created: revenue, the number of users, and the number of commercial contracts. (ROUSSIERE, 2009)

A 'significant digital presence' would thus be deemed to exist where the company or group exceeds, within a Member State and for a given tax year, one of the following three alternative thresholds:

- €7 million in revenue resulting from the provision of digital services;
- 100,000 users of these digital services;
- 3,000 commercial contracts for the provision of such digital services.

In this regard, it could be said that, at the international level, even a significant digital presence was sufficient to establish taxation in a country. Advertising revenue could be taxed in that country, even though the transaction takes place between two parties who may be located in two other countries. However, if the server, in addition to advertising activities, records customer orders and accepts their payments, paragraph 4 of Article 5 of the OECD model tax convention does not apply, since in this case there is a permanent establishment due to a combination of activities. (KHOURI-HELOU, 2014, p. 3)

Furthermore, on the issue of digital permanent establishments – 'significant digital presence' – discussions are ongoing and the development of a framework may take some time, given the complexity of the concept (the attractiveness of states, competition, defining the criteria for an appropriate tax model, determining digital profit, etc.).

c- The proposal for a directive COM(2018) 147 final on significant digital presence

The proposal for Directive COM(2018) 147 final aims to reform, initially at European Union level, the rules governing the corporate income tax tax base. It allows Member States to tax, within their territory, profits derived from digital activities carried out there, even in the absence of a physical presence of the company.

Under this directive, a significant digital presence is considered a new criterion for qualifying a permanent establishment in a State other than that of its residence. The primary aim is to supplement the current definition of a permanent establishment – which allows a company to be taxed in another territory – with the criterion of 'significant digital presence'.

Similarly, Article 4 of the proposed Directive COM(2018) 147 final provides for the introduction of the criterion of 'significant digital presence' to qualify a permanent establishment, which amounts to introducing the concept of a 'virtual permanent establishment', where a company carries out all or part of its business in the form of digital services. (MONTGOLFIER, 2017–2016)

2- Taxation of the digital economy under Algerian law

In Algeria, electronic commerce raises a significant issue of territoriality regarding which country has the right to tax the profits from such trade. The question of the location of an intangible service brings us back once again to the concept of a permanent establishment.

It should be noted that Algerian taxation is based on the territoriality principle. According to Article 137 of the CIDTA, only profits made by companies established within its territory are subject to Algerian tax. In this regard, the

taxation of goods and services in Algeria has always been based on the physical movement of goods or the provision of services. Consequently, it is becoming increasingly difficult to determine where the basis of a product's profit lies and who has the right to tax it, potentially paving the way for double taxation?

a. The difficulty of classifying income in digital transactions

The main difficulty associated with the internet concerns linking a transaction to a geographical location, given that the parties involved cannot be geographically located. Furthermore, difficulties have arisen in classifying the subject of the transaction (product or service) for the application of the relevant rates. (BASU, 2008, p. 01)

Similarly, the emergence of digital commerce increases the implications of characterising the revenue generated: royalties or business profits. In this case, the nature of an item of revenue is important in determining the source, as the source of the revenue depends on its nature.

Indeed, digitization plays a role in broadening the scope of digital services. Digital services can be provided rather than face-to-face. Goods can be transformed into services deliverable online. For example, initially, software had to be installed locally on a computer using a physical disc. Today, many software applications take the virtual form of a website (for example,

Dropbox[2]) which provides a service accessible via the Internet without the need for a local distribution medium. (NATIONS UNITED, 2017)

b- Electronic commerce in the light of the new law of 10 May 2018

Algeria has finally introduced legislation to regulate electronic commerce. The law on electronic commerce was published in the Official Gazette, issue 28, on 16 May 2018. Electronic commerce is now governed by Law No. 18-05 of 10 May 2018.

This legislation sets out the conditions for conducting electronic commerce, as well as the duties and obligations of the parties to an electronic contract. (Article 1 of Law No. 18-05, 2018)

However, in Article 3 of the same law, the legislator prohibits any transaction via electronic communications relating to:

- games of chance, betting and lotteries;
- alcoholic beverages and tobacco;

- pharmaceutical products;
- products infringing intellectual, industrial or commercial property rights;
- any goods or services prohibited by the legislation in force;
- Any goods or services requiring a notarised document.

Similarly, for the purposes of this Act, the legislator has defined electronic commerce as an "activity whereby an e-supplier offers or provides, to an e-consumer, remotely and by means of electronic communications, the supply of goods and services". (Article 1 of Law No. 18-05, 2018)

c- The implementation of Law No. 18-05 of 2018

In order to regulate and supervise economic operators offering their services in Algeria via electronic means of communication and thereby evading any regulatory framework, the Algerian legislature introduced a law on electronic commerce in 2018 to bring national legislation into line with international norms and standards in this area.

Furthermore, pursuant to Article 3 of Algerian Law No. 18-05 on electronic commerce, all transactions conducted via electronic communications are subject to the duties and taxes provided for by the legislation and regulations in force. (Article 1 of Law No. 18-05, 2018) The provisions of this law, and with reference to the provisions of Article 7, the Algerian law on electronic commerce stipulates: "The purchase via electronic communications of a digital good and/or a set of digital services from Algeria by an e-consumer[4] from an e-supplier[5] established in a foreign country and intended exclusively for personal use, is exempt from foreign trade and exchange formalities where its value does not exceed the dinar equivalent of the limit set by the legislation and regulations in force" (Article 1 of Law No. 18-05, 2018)

Through Article 10 of the 2019 Finance Act, the Algerian tax authorities have introduced a tax regime applicable to direct online sales and transactions carried out via digital platforms. This is a tax regime, in the form of a withholding tax under the single flat-rate tax 'IFU', which is governed by the provisions of Articles 282 sexiès A and 282 septiès of the Code of Direct Taxes and Similar Levies.

Indeed, under these provisions, a 5% withholding tax under the IFU applies to natural persons acting as intermediaries for the distribution of goods and services via digital platforms or as intermediaries for direct sales to the end consumer via networks. (Article 10 of Law No. 18-18, 2018) In fact, this withholding applies both to natural persons registered with the tax administration (subject, for example, to

the IFU in respect of another activity) and to those not registered who carry out these operations on an occasional or ancillary basis.

Conclusion:

Following our study of the digital economy, it is clear that current corporate tax rules are no longer suited to the modern context. Corporate income is taxed at national level, whereas the economic environment is increasingly characterised by globalisation, mobility and digitalisation. Business models and corporate structures have become more complex, making profit shifting easier. It is therefore increasingly difficult to determine which country should tax the income of a multinational enterprise.

Some companies exploit this situation to artificially shift profits to tax jurisdictions with the lowest tax rates and minimise their overall tax liability. The fact that some profitable multinationals pay little tax on their profits, whilst many citizens are severely affected by budgetary adjustment efforts, has sparked public discontent. This sense of unfairness poses a threat to the social contract between governments and their citizens, and may even affect their tax obligations in general.

We propose, at this stage, to urgently tackle abusive tax practices engaged in by companies and to review the rules governing Algerian corporate taxation in order to combat aggressive tax planning more effectively; this involves exploiting the intricacies of a tax system or inconsistencies between two or more tax systems to reduce the tax liability. In accordance with the European Commission's recommendation of 6 December 2012.

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[1]- Electronic commerce is simply the process of buying and selling products via electronic means such as mobile apps and the internet; it refers to both retail and online purchases as well as electronic transactions. According to www.ecomerce-platforms.com.

[2]- Double taxation in electronic commerce may occur where the source country considers it has the right to tax, whilst the country of residence also considers it has the right to tax, meaning a transaction may be taxed by two different countries.

[3]- The failure to adapt tax rules leaves room for manipulation with the emergence of electronic commerce, which offers tempting opportunities for tax evasion, insofar as determining the place from which transactions are carried out is not straightforward. Afak Ilmia Journal, 'The suitability of the rules laid down in tax treaties for electronic commerce', volume 13, No. 03, 2021, p. 101 https://www.asgp.cerist.dz.

[4]- Under Algerian law, an 'e-supplier' means any natural or legal person who markets or offers to supply goods or services by means of electronic communications.

[5]- Under Algerian law, an 'e-supplier' means any natural or legal person who markets or offers to supply goods or services by means of electronic communications.