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TRANSFER PRICING IN AN E-COMMERCE ENVIRONMENT: OBSERVATIONS ON THE OECD DISCUSSION PAPER ON ATTRIBUTION OF PROFIT TO A PERMANENT ESTABLISHMENT

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Last winter, the OECD issued various discussion papers and reports addressing the taxation of e-commerce. The conclusions and recommendations reached in these reports, as well as the suggestions and hypotheses raised in the discussion papers, are designed to stimulate discussion in the international tax community with the goal of achieving consensus on policies governing the taxation of e-commerce activities.

This article briefly reviews the conclusions reached by the OECD on the application of the existing permanent establishment rules to profits derived from e-commerce. The authors' main focus, however, is on the OECD discussion paper dealing with the attribution of profit to a permanent establishment conducting e-commerce transactions.

The discussion paper concludes that a permanent establishment consisting of only a server should have very little profit attributed to it. The discussion paper also concludes that a permanent establishment should be treated the same as a subsidiary that performs the same functions. However, considerable latitude is allowed in how risks and intangibles should be allocated to a permanent establishment. As a result, it is possible that more profit could be allocated to a permanent establishment than would occur under the arm's-length principle. In turn, more profit might be attributed to a permanent establishment than would be considered reasonable in a parent-subsidiary relationship. Thus, the OECD's suggested approach could perpetuate an existing inequity associated with the computation of branch income.

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The authors review the concepts and hypotheses set out in the OECD discussion paper and consider their possible implications from the perspective of the current Canadian transfer-pricing landscape. ***Keywords:*** *Arm's length transactions; electronic commerce; intangibles; OECD; permanent establishments; tax models; transfer pricing.*