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E-commerce Taxation as an Example of Legal Deadlock²

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Abstract

Many of the principles of taxation that were developed in the first half of the 20th century, such as the *arm's length principle* and the definition of the term “permanent establishment” (PE) in determining the tax position of international business operations, when applied to the business models of the 21st century, often result in the under-taxation of businesses that are otherwise fully compliant with the laws as presently written and implemented. Compounding the problem is the fact that these rules and principles of taxation are broadly recognized and are enshrined in a wide network of tax treaties. This makes the task of modifying or updating these rules and principals extremely difficult. Using legal-dogmatic and legal-theoretical methods, the author will show that present attempts to tax e-commerce transactions unilaterally are not effective and that, under present conditions, even organizations such as the EU are unable to address the problem at hand. The OECD project, commissioned by the G-20, which seeks to create a set of international e-commerce taxation rules, faces some very serious difficulties – largely because a well-established “set in stone” complement of internationally accepted laws, rules, and regulations is serving to block the development of new, more appropriate rules.³ This phenomenon has become known as the *lock-in effect* or *legal impossibilism*. In order to effectively address this phenomenon, lawmakers on a global basis must understand the mechanisms that are blocking the effective evolution of business taxation.

Keywords: e-commerce, international taxation, lock-in effect.

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² The research was not financed by any institution.

³ OECD Secretary-General, *Tax Report to G20 Finance Ministers and Central Bank Governors – October 2020 Saudi Arabia*, October 2020, pp. 9–16.

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Opodatkowanie e-commerce jako przykład imposybilizmu prawnego⁴

Streszczenie

Wypracowane w pierwszej połowie XX wieku zasady opodatkowania dochodów z działalności transgranicznej, takie jak standard Arm's Length i rozwiązania dotyczące pojęcia tzw. zakładu (Permanent Establishment) wiążące państwa w stosunkach międzynarodowych, w połączeniu z możliwościami planowania podatkowego dostępnymi w wieku XXI, prowadzą do powstania sytuacji, w której w całkowitej zgodzie z obowiązującym prawem, znaczące dochody mogą być nieopodatkowane. Próby wprowadzenia odpowiednich danin przez poszczególne państwa nie są skuteczne i nawet organizacje takie jak UE nie potrafią przełamać zjawiska imposybilizmu prawnego (nazywanego w zakresie badanej tematyki *lock-in effect*). Obecnie prace (na zlecenie G20) mające zakończyć się projektem światowego podatku e-commerce prowadzi OECD napotykać bardzo poważne praktyczne trudności, co potwierdza siłę petyfikacji i imposybilizmu prawnego. Wydaje się jednak, że jeżeli rozwiązanie zostanie wypracowane może ono być bardzo istotne dla ewolucji światowego ładu podatkowego.

Słowa kluczowe: e-commerce, podatki międzynarodowe, imposybilizm prawny.

⁴ Badania wykorzystane w artykule nie zostały sfinansowane przez żadną instytucję.

Legal impossibilism

The term “legal impossibilism” was coined to describe the current political climate. On the theoretical level, it was Jerzy Zajadło (Professor of Law at the University of Gdansk) who introduced the concept of legal impossibilism in terms of current legal development.⁵ For the purposes of this study, the author defines the term to refer to a situation in which laws and regulations cannot be updated or changed due to obstacles inherent in the current law or to political and economic conditions. Most of us can think of examples of internal contradictions in laws and legal practice, regulations that fail to address practical problems arising from current realities (e.g., privacy rights on social media), incompleteness of current laws and regulations given evolving practices and technology, technical failures of regulations in addressing the current practices for which they were written and the unsuitability of current laws, regulations and practice for the situations that they are intended to regulate.

Background: taxation of e-commerce

At the end of the 20th century, the emergence and rapid growth of the internet brought significant opportunities and resulted in a rapid change and evolution of business practices. These changes necessitated the creation of new (or the adaptation of current) methods and mechanisms of taxation. The past 25 years are stark testimony to the difficulty of such a task.

As a result of such failures, e-commerce companies – though very profitable – pay relatively low taxes.⁶ This applies to both indirect and direct taxes. Although this article focuses on income taxation, indirect taxes on the sale of goods and services is equally problematic when it comes to the inadequacy of current laws and regulations.⁷

The internet has created opportunities to provide services and sell goods without the need for the seller and the buyer to be physically present at a retail

⁵ J. Zajadło, *Pojęcie „imposybilizm prawny” a polityczność prawa i prawoznawstwa*, PIP 2017, nr 3/2017, pp. 17–30.

⁶ See: Report Fair Tax Mark, *The Silicon Six and Their 100 Billion Global Tax Gap Dollars*, 2019, pp. 14–19.

⁷ M. Martynkiewicz-Frank, *E-commerce Challenge within B2C Transactions inside EU Countries*, “Prace Naukowe Uniwersytetu Ekonomicznego we Wrocławiu” 2012, nr 515, pp. 157–165.

outlet.⁸ Digitalization also made it possible to perform work, manage business transactions, and control practically every stage of the business process remotely.⁹ As business owners became aware of the advantages that e-commerce offers, the internet expanded exponentially in terms of the range of information and facilities available and the number of internet-based businesses, and conventional businesses utilizing internet-based platforms increased at an unprecedented rate. This rapid evolution brought unprecedented opportunity for global expansion and increased visibility, and importance (both politically and socially), as businesses became increasingly able to reach larger and ever more diverse groups of consumers.

This article focuses on industries that trade via the internet, offering online goods and services, e-advertising and the like. These are referred to collectively as “e-commerce” for the purposes of this study.¹⁰ Classic examples of e-commerce companies include Apple, Facebook, Google, and Amazon. Such companies are often referred to as “Big Tech” or with acronyms such as “GAFA” and “FAANG.”¹¹ Although the above-mentioned companies can serve as model examples, it should be remembered that there are hundreds of entities with similar operating models.

The 21st century brought with it a surge of governmental efforts aimed at increasing tax revenues.¹² Governments are desperately looking for additional sources of funds, and yet, e-commerce remains largely undertaxed.¹³ This is bad news all the way around. First of all, such a tax disparity deprives state budgets of revenue, preventing proper financing of government obligations. Undertaxation also allows for unfair competition – traditional business must compete with e-businesses that enjoy unintended advantages due to the failure of tax laws to evolve accordingly.

Traditional businesses are subject to general tax obligations that many Big Tech companies are able to avoid. Furthermore, governments are able to effectively tax local e-businesses.¹⁴ This creates the impression that modernization combined

⁸ D. Chalimoniuk, *Rozwój Internetu jako szansa dla przedsiębiorstw*, „Zeszyty Naukowe UP-H w Siedlcach” 2011, nr 88, pp. 207–217.

⁹ T. Doligalski, *Internet Business Models and Types of Goods Offered*, “Journal of Business Models” 2018, nr 2, pp. 32–36.

¹⁰ In this article, the author refers to the European Court of Auditors definition of e-commerce: *E-commerce is the sale or purchase of goods or services conducted via the internet or other online communication networks* from the Report titled: *E-commerce: Many of the challenges of collecting VAT and customs duties remain to be resolved*, 12/2009, p. 4.

¹¹ <https://www.investopedia.com/terms/f/faang-stocks.asp> (accessed: 11.08.2020).

¹² P. Kohler, *Asset-Centred Redistributive Policies for Sustainable Development*, 12th International Post-Keynesian Conference Paper, September 28, 2014, p. 18.

¹³ N. Jain, *Tax Evasion a Dark Side of E-commerce*, “International Journal of Engineering and Management Research” 2013, No. 5, pp. 16–18.

¹⁴ M. Radvan, *Taxation of Instagram Influencers*, “Studia Iuridica Lublinensia” 2021, No. 2, pp. 339–356.

with globalization provide tax avoidance opportunities. This inequity also presents an ethical issue.¹⁵ E-commerce companies generate significant revenues, which are not shared with society – which is, after all, the source of their success and wealth¹⁶. This all begs the question: why are governments (which have budgetary needs, which have demonstrated a desire to tax e-commerce and which acknowledge the necessity of such a tax) not taxing e-commerce ventures?

It is the author's belief that the main obstacle to the reforms needed to promulgate and implement an effective e-commerce tax regime is the present system itself. The nature of the existing set of laws – including the network of treaties and the logistics of creating and implementing a set of universal definitions and mechanisms that can be agreed internationally – serve to make any substantive change very difficult. Add to that the fact that there are legions of e-commerce lobbyists who have a vested interest in maintaining the *status quo*. The deadlock that results from these obstacles is, the author would submit, an excellent example of the *legal impossibility* to which Professor Jerzy Zajadło refers.

Along with practical problems, there are political obstacles to the needed reform. Many Big Tech companies originate from the USA – which is well known for its protectionist policies and for imposing its own policies rather than adopting internationally approved models.¹⁷ Washington has the clout to force other governments to cease actions perceived as unfavorable to American interests. This protectionist approach extends to the taxation of e-commerce.¹⁸ Taxpayers themselves also lobby to avoid or minimize taxation.¹⁹ Although this article is not intended to focus on political issues, or on the many technical problems that meaningful international tax reform presents, one must be aware that these present serious obstacles to the creation of an architecture of the taxation of online activity.²⁰

¹⁵ S. Colle, A. Bennett, *State-induced, Strategic, or Toxic? An Ethical Analysis of Tax Avoidance Practices*, "Business and Professional Ethics Journal" 2014, No. 33, pp. 53–82.

¹⁶ M. G. Simkin, G.W. Bartlett, J.P. Shim, *Pros and Cons of E-commerce Taxation*, "International Business & Economics Research Journal" 2011, No. 2, pp. 61–70.

¹⁷ L. Ahrens, F. Bothner, *The Big Bang: Tax Evasion After Automatic Exchange of Information Under FATCA and CRS*, "New Political Economy" 2019, No. 6, pp. 849–864.

¹⁸ B.T. Ward, J.C. Sipior, *To Tax or Not to Tax E-commerce: A United States Perspective*, "Journal of Electronic Commerce Research" 2004, No. 5, pp. 172–180.

¹⁹ T. Romm, *Tech giants led by Amazon, Facebook and Google spent nearly half a billion on lobbying over the past decade, new data shows*, "The Washington Post" 2020, January 22.

²⁰ A. Atanassova, *Accounting problems in e-commerce*, "Ekonomiczne Problemy Usług" 2018, nr 2, pp. 19–30.

E-business – mobile, flexible, borderless

There are several features of e-commerce that contribute to the difficulty of the taxation question.

First, the very nature of e-commerce involves a significant transfer of business activity from the physical/real world (as traditionally perceived, i.e., as a physical presence in a given jurisdiction) to the virtual world (i.e., an abstract space that is not confined to a particular location or territory). This occurs both at the organizational level and at the level of fulfillment (i.e., the actual provision of services and work). This distinction is fundamentally important when determining to which particular jurisdiction a tax-paying company is bound. A company's registration in a certain jurisdiction forces compliance with the legal requirements of that particular jurisdiction, but the organizational form that the company takes can be quite flexible. For instance, the board can run the company without any fixed or permanent, physical presence. The key assets of most such companies consist of intellectual property (IP), which can be created and owned virtually and can be transferred between locations, unlike real estate or other physical assets. Business activity can occur virtually (although this conclusion is frequently disputed) outside the area commonly recognized as the territory of the country in question.²¹ Moving business to virtual space means that it is possible to reach all countries with a service or product, without entering the territory of many, if not most, of those countries.²²

Second, e-commerce is vastly mobile and can be operated and managed remotely. Also, technology allows for the easy transfer of capital and assets (including IP) from one country to another. Moreover, such companies can outsource non-core functions to independent external entities, which results in the e-commerce entity having no physical tie to the place where those external, service providing entities are actually located.^{23 24}

The nature of e-commerce companies allows them to freely create and modify their legal structures on an *ad hoc* basis. This allows companies to locate their assets (which are largely IP-related) in countries with low tax rates or, in some cases, even

²¹ E. Hadzhieva, *Impact of Digitalisation on International Tax Matters*, Report for Policy Department for Economic, Scientific and Quality of Life Policies Directorate-General for Internal Policies of the European Parliament, pp. 72–79.

²² M. Mwencha, *Taxation of electronic commerce – a commentary*, pp. 69–78. Obtained from: www.academia.edu/40141032/TAXATION_OF_ELECTRONIC_COMMERCE_-_A_COMMENTARY (accessed: 11.03.2020).

²³ K. Rybiński, *Outsourcing i offshoring usług. Siatka pojęć, trendy i bariery rozwojowe*, [in:] *Globalizacja usług. Outsourcing, offshoring i shared services centers*, ed. A. Szymaniak, Poznań 2007, pp. 169–188.

²⁴ J. Akhtar, V. Gronдона, *Tax Haven listing in multiple hues: Blind winking and conniving*, "South Center Research Papers" 2019, nr 94, p. 2.

to negotiate their own special tax rates. It also allows for the use of hybrid structures.²⁵ These opportunities, combined with the competition between countries for business investment, have led to the development and widespread use of tax schemes that can significantly reduce a company's tax bill.²⁶

Attempts to tax e-commerce

The problem of e-commerce taxation is not new; it dates back to at least the mid-1990s, when the question of taxing the internet first arose. Early on, it was postulated that cyberspace should be temporarily treated as a tax-free zone under certain conditions. However, it was quickly noticed that the internet gave private, commercial entities very high-income potential, and there was no reason why such companies should escape taxation.²⁷

Over the years, there have been various attempts to implement multilateral laws to tax the income of e-commerce companies. Lawmakers in many countries have also attempted to introduce their own tax regimes.²⁸ Italy, the Czech Republic, Austria, and Spain are amongst those countries that have sought to implement such a tax. Recently, the government of France attempted to introduce a digital tax. The results, however, have been disappointing. This is because such a tax cannot succeed without a change to the existing tax mechanisms and to generally accepted international tax principles, neither of which is adequate for addressing the reality of the new technology and neither of which equips governments with the tools needed to effectively tax e-commerce entities. There have been attempts to broaden the interpretation of existing rules – both through administrative directives and through court decisions, but the room for maneuver within the existing framework seems to be limited.²⁹

International organizations are also considering some coordinated approach to the taxation of e-commerce income. For instance, the EU Parliament has considered

²⁵ M. Hybka, *Optymalizacja podatkowa z wykorzystaniem hybrydyzacji*, „Zeszyty Naukowe Uniwersytetu Szczecińskiego. Finanse, Rynki Finansowe, Ubezpieczenia” 2014, nr 65, pp. 83–92.

²⁶ R. Hansen, *Taking More than They Give: MNE Tax Privateering and Apple's "Ocean" Income*, “German Law Journal” 2018, No. 4, pp. 693–726.

²⁷ W. Cui, *The Superiority of the Digital Services Tax over Significant Digital Presence Proposals*, “National Tax Journal” 2019, nr 4, pp. 839–856.

²⁸ R. Azam, *Global taxation of cross border e-commerce income*, “Virginia Tax Review” 2011, No. 31, pp. 639–694.

²⁹ Italian Supreme Court case 7682 of May 25, 2002. This case led to a change in the definition of PE under Italian law. Stefano Loconte, *A New Definition of Permanent Establishment in Italian Domestic Income Law*, <http://publications.ruchelaw.com/news/2018-03/Italy-Permanent-Establishment.pdf>. (accessed: 11.08. 2020).

several measures intended to change existing international tax principles or, alternatively, to introduce a completely new tax with excise duty characteristics.³⁰ So far, attempts to introduce changes to the existing regime have proven unsuccessful.

Currently, the OECD is seeking to coordinate these varied attempts into a global approach based on the assumption that e-commerce is “an area, in which no country can act on its own.” Such work has been underway (with very modest results) since the organization’s first meeting on the subject – more than 22 years ago in Ottawa, Canada.³¹

Up until now, attempts at an international tax regime on the e-commerce industry have met with strong resistance. There have been emotional arguments against such measures (internet freedom vs. tax burden) as well as political positions (largely on the part of the US, but other countries, i.e., Ireland and Sweden have also expressed political concerns). Additionally, there are practical arguments behind such resistance (taxed entities might take their business out of our country), as well as populist concerns (fear that taxing the Internet will result in an increase in prices of services and goods offered and this will result in customer/voter dissatisfaction). There are also strong legal principles behind the resistance to any international tax initiatives.

The problem with established international tax rules

The current rules on the taxation of income from international transactions were developed in the first half of the 20th century. At the beginning of the century, trade between the countries of Europe and North America grew at an unprecedented pace. This rapid growth in international trade, combined with technical advance and development in the legal arena, led to a consistent, sustained, and rapid increase in the number of foreign company branches.

The income of these foreign operations was taxed in the country where their transactions took place. At the same time, the governments of the countries in which the parent companies were based sought to tax the companies’ *worldwide income* – ultimately resulting in *double taxation*.

³⁰ European Parliament Report, *Tax Challenges in Digital Economy*, pp. 67–72. Obtained from: www.europarl.europa.eu/RegData/etudes/STUD/2016/579002/IPOL_STU%282016%29579002_EN.pdf. (accessed: 11.08.2020).

³¹ D. Holmes, *E-commerce tax: A sober view of cyberspace*, “OECD Observer” 2002, No. 230, https://oecdobserver.org/news/archivestory.php/aid/669/E-commerce_tax:_A_sober_view_of_cyberspace.html (accessed: 11.08.2020).

Business owners, taxpayers, and governments began to recognize the need to develop a solution to the problem that double taxation would present. Moreover, they saw the need to develop a practical system that would allow for fair and equitable distribution of income tax revenues on a broad, international scale between countries with equal and potentially conflicting taxing rights.

The process of developing an international tax regime began with the conclusion of bilateral agreements on the avoidance of double taxation. Although such agreements have their roots in the *Friendship, Commerce and Navigation* treaties, it was not until the early 20th century that the development of the network of tax rules and regulations that we know today began – led by the League of Nations and later by the OECD.³² The involvement of international organizations was important because the number of countries interested in signing agreements was growing rapidly, and such organizations could offer greater efficiency and a more streamlined process of promulgation than was otherwise possible. One of the finest examples of the efficacy of an international organization's involvement in this area is the Model Tax Convention – initially developed by the League of Nations and undertaken by the OECD after World War II. The UN has also had a hand in developing the Model Tax Convention that we know today.³³ These early models were fundamental. They shaped the international tax law and practice for decades and are generally valid and respected to this day.

For cross-border activities, it was most important to adopt the principle of taxation of income at the source, which means that the income may be taxed by the state in which the taxpayer earned it. In practice, it was necessary to precisely define the conditions under which income is considered to be earned within the jurisdiction of a given country. Thus, the concept of *permanent establishment* (PE) was created.³⁴ The existence of a permanent establishment is a fundamental condition for taxation of a company in a foreign jurisdiction. If a taxpayer does not have PE in a given country, as a rule, it is not subject to taxation there.³⁵ There may be exceptions to the general rule for specific types of income such as interest, dividends, capital gains or royalties.

³² L. Friedlander, S. Wilkie, *Policy forum: The history of tax treaties provisions and why it is important to know about it*. Obtained from: www.uniheidelberg.de/institute/fak2/mussnug/historyoftaxdocuments/schrifttum/aufsaetze/AUFS00020.pdf. (accessed: 11.08.2020).

³³ In addition to the OECD and UN tax treaties models, other models exist, for instance, the ASEAN Model, the East Africa Community (EAC) Model, the Common Market for Eastern and Southern Africa (COMESA) Model, etc.

³⁴ A. A. Skaar, *Erosion of the Concept of Permanent Establishment: Electronic Commerce*, "Intertax" 2000, No. 5, pp. 188–194.

³⁵ K. Siliąs, *Taxation of E-commerce – A Task for Jugglers*, "Masaryk University Journal of Law and Technology" 2014, pp. 141–154.

The business model of an e-commerce venture, however, allows for the generation of income without establishing a taxable presence in other countries.³⁶ This is so because, in the absence of a taxable presence, the traditional features of PE do not apply. Any foreign “presence” could very well be limited to the location of the company’s server.³⁷ Thus, the e-commerce company’s activity does not meet the definition of a PE and, without PE, there is no authority to tax the company’s income without violating current treaty principles and established international tax standards.³⁸

Just as important as the question of the definition of PE is the universal acceptance of the *arm’s length principle* (ALP). This rule states that each company and its foreign branch are treated as separate entities, and transactions between them are treated as transactions between two separate tax-paying entities. In practice, this means that taxable income is determined separately for each entity according to an analysis of its transactions (including cross-border transactions). Recognizing a foreign subsidiary as separate from the parent company (and other entities in the corporation) means that even if there is a PE of a Big Tech company in a given country, that country may tax only the portion of the parent company’s income arising in that country that is attributable to that particular PE. In the case of e-commerce companies, due to the specific nature of their activities, a local presence usually does not constitute a PE, and if it does, there is little, if any, income that can be attributed to it. This leads to undertaxation.³⁹

To understand the effect of ALP on the current taxation gridlock, one must remember that ALP was not the only mechanism originally considered, nearly a century ago, for the taxing of foreign income of international corporations. International policy makers also considered the concept of *formulary apportionment* (FA). FA provides for allocation of a corporation’s profit between the entities (parent company and branches/subsidiaries in all countries) at a global level, based on subjective criteria (e.g., turnover or employment) with the help of certain coefficients. Not surprisingly, in the current discussion on a global solution for the e-commerce tax, the idea of reintroducing the FA principle appears regularly and has loyal supporters.⁴⁰ Replacing ALP with the FA model would make it technically possible

³⁶ I. Krzemińska, Propozycje opodatkowania znaczącej obecności cyfrowej w Unii Europejskiej, „Krytyka Prawa” 2019, nr 2, pp. 87–102.

³⁷ M. Jamróży, *Zakład zagraniczny w kontekście planu BEPS*, „Studia Ekonomiczne. Zeszyty Naukowe Uniwersytetu Ekonomicznego w Katowicach” 2016, nr 294, pp. 67.

³⁸ M. Geurts, *Server as a Permanent Establishment?* „Intertax” 2000, nr 4, pp. 173–175.

³⁹ M. Jamróży, *op. cit.*, pp. 60–71.

⁴⁰ UN Committee of Experts on International Cooperation in Tax Matters Report on the Sixth Session (18–22 October 2010), Economic and Social Council Official Records, 2010 Supplement No. 25, p. 10.

to impose a single tax on the global income of the corporation and distribute it among the countries whose territory the income originates from.

Efforts to promote the principle of income allocation, over the ALP, were undertaken until the mid-twentieth century (mainly by Princeton University specialists) and were supported in a theoretical work by Mitchell B. Carroll in a publication known as the Carroll Report.⁴¹ The League of Nations adopted the *arm's length* standard in 1936 and incorporated it into Article 6 of the draft *Convention on Allocation of Profits and Property of International Enterprises*.⁴² This was seen as a breakthrough development in the area of international taxation.⁴³ There were later attempts to introduce the FA principle into international conventions – for instance, the *Mexico Draft* and *London Draft* in 1943 and 1946, respectively – but these proved unsuccessful. As a result, Article 6 of the Convention became the inspiration for Article 9 of the OECD draft Convention of 1963, which is in force (with modifications) to date.⁴⁴ The OECD Double Treaty Convention is a widely used model for negotiating tax treaties between states and for interpreting existing treaties. The impact of the OECD model is enormous. It incorporated both the ALP principle and the definition of the PE into international tax law so that they became an integral part of the established global tax order.⁴⁵

It should be noted that there is no shortage of criticism of the current tax regime – particularly when it comes to the shortcomings of the ALP mechanisms.⁴⁶ However, both definitions – ALP and PE – also appear in international taxation documents prepared by other organizations (e.g., the UN). These documents, in fact, helped to turn those principles into international law.⁴⁷ Limitations of the ALP principle and the definition of PE make the international taxation of Big Tech companies' income practically impossible, using currently available regulations.⁴⁸ Despite, or perhaps due to, the existence of precise rules and many years of practice

⁴¹ P. Hewitt, A. Lymer, L. Oats, *History of International Business Taxation*, [in:] *The International Taxation System*, eds. A. Lymer, J. Hasseldyne, New York 2002, p. 53.

⁴² M. Schroger, *Next steps in international debate*, [in:] *Tax Policy Challenges in the 21st Century*, eds. K. Spies, R. Petruzzini, L. Verlag, Vienna 2014, pp. 302.

⁴³ V. Solilova, D. Nerudova *Transfer Pricing in SMEs: Critical Analysis and Practical Solutions*, Brno 2018, p. 14.

⁴⁴ https://read.oecd-ilibrary.org/taxation/draft-double-taxation-convention-on-income-and-capital_9789264073241-en#page4. (accessed: 11.08.2020).

⁴⁵ M. Malicka, A. Zalasinski, *Rola oficjalnego Komentarza do Modelu Konwencji OECD w interpretacji umów dotyczących unikania podwójnego opodatkowania opartych na tym Modelu*, „Kwartalnik Prawa Podatkowego” 2005, nr 1, p. 98.

⁴⁶ A. Kayis-Kumar, *Taxing cross-border intercompany transactions: Are financing activities fungible?* “Australian Tax Forum” 2015, nr 30, pp. 627–661.

⁴⁷ A. Readhead, *Preventing Tax Base Erosion in Africa: A Regional Study on Transfer Pricing Challenges in the Mining Sector*, Natural Resource Governance Institute, July 2016, pp. 34–36.

⁴⁸ C. Makunike, *The Nexus between Tax Treaties, Transfer Pricing and BEPS: Lessons for African Tax Policy Makers and Administrators*, “ATRN working paper”, No. 5, May 2016, pp. 1–20.

in their application, states do not have the proper tools to enable them to effectively tax the income of e-commerce companies. It is noted that “the current legal and tax infrastructure on a global scale, i.e., based primarily upon the agreements on the avoidance of double taxation, does not ensure the efficiency of collecting public levies, nor does it allow for taxation of income in the territory of the state where it actually arises.”⁴⁹ The current regime was created at a time when the activities that can now be carried out thanks to the existence of the e-commerce were impossible to imagine. Lawmakers did not foresee such a necessity and, accordingly, did not create any tools for taxing such activity. In fact, the present mechanisms are so effective for the purpose for which they were created that they also serve to prevent the taxation of e-commerce without breaching generally accepted principles of taxation. These mechanisms served to solidify international regulations with the assistance of a network of treaties based on the same model. This created a system that is inflexible and yet deeply rooted in practice which, in turn, makes it very difficult to change.

Effective development of tools for taxing this type of income requires a major change in approach. Such an approach would likely require the abandonment, or at least the reformation, of the ALP principle and the redefinition of PE.⁵⁰ Unfortunately, under the current structure of international tax law and regulation, there are limited opportunities for quick reform of well-established *nexus norms*.⁵¹ This is because “tax law in the global economy continues to be based on unilateral and bilateral treaties rather than multilateral solutions.”⁵²

The existence of a network of more than 3,000 treaties on tax avoidance can be considered a significant achievement and an important element of the global tax order.⁵³ However, in the case of new industries, the treaties allow for tax avoidance, either through definitional weaknesses or the shifting of income to a state with a lower rate (especially through treaty shopping or transfer prices).⁵⁴ As a result, treaties may give rise to a phenomenon known as *double non-taxation*.⁵⁵

⁴⁹ I. Krzemińska, *op. cit.*, p. 98.

⁵⁰ M. Gregg, *Genuine Nexus or Perpetual Allegiance? (Some Considerations on the ‘Diverted Profit Tax’ Proposal)*, Draft for TRN Conference 2015.

⁵¹ S. Gadžo, *Nexus requirements for taxation of non-residents business income: A normative evaluation in the context of the global economy*, Amsterdam 2018, p. 9.

⁵² R. Azam, *Ruling the World: Generating International Tax Norms in the Era of Globalization and BEPS*, “Suffolk University Law Review” 2017, No. 4, p. 554.

⁵³ E. Quak, H. Timmis, *Double Taxation Agreements and Developing Countries*, Institute of Development Studies K4D Helpdesk Report 2018, p. 2.

⁵⁴ S. Davidson, Ch. Berg, *Submission to the Senate Inquiry into Corporate Tax Avoidance Institute of Public Affairs 2015*, www.ipa.org.au. (accessed: 11.08.2020), p. 19.

⁵⁵ J. Roin, *Can income from capital be taxed: An international perspective*, [in:], *Taxing Capital Income*, eds. H. Aaron, L. Burman, E. Struerle, Chicago 2007.

The lock-in effect

The legal impossibility of taxing Big Tech income has been noticed by researchers. This phenomenon was discussed by, among others, Professor Eduardo Baistrocchi of the London School of Economics, who defined the concept of the lock-in effect. This term refers to a situation where the established standard of conduct, due to its strong roots in the legal system, prevents the introduction of a newer, more adequate standard. The universality of the existing rules in international taxes, in connection with the mechanism of their application (international treaties), makes it impossible to quickly and efficiently depart from the traditional definition of the PE and application of the ALP.⁵⁶ The lock-in effect impacts developing countries particularly heavily, as noticed by researchers.⁵⁷

The legal impossibility of effective e-commerce income taxation is an example of a situation where a traditional, proven and widely accepted approach becomes obsolete as it is currently applied and requires change.⁵⁸ Unfortunately, changing the *status quo* in an international context is much more difficult than amending one country's domestic tax law. Necessary improvements would likely have to be made either through a massive modification of double tax treaties (as, to some extent, it is the case with the OECD's Base Erosion and Profit Shifting project) or by the effective introduction of a unified global solution endorsed by an international organization with the ability to prepare and promote them.⁵⁹ The OECD is currently working on such an undertaking, but one could also expect the United Nations and the WTO to undertake the task.⁶⁰

Can we overcome impossibilism?

Frustration with the lack of the taxation of e-commerce has led to a multi-national effort to arrive at a solution to the problem.⁶¹ France has taken one of the more

⁵⁶ E. Baistrocchi, *The Use and Interpretation of Tax Treaties in the Emerging World: Theory and Implications*, "British Tax Review" 2008, nr 4, pp. 352–391.

⁵⁷ Y. Ngantung *Tax treaties and developing countries*, [in:] *Tax policy challenges in the 21st century*, eds. R. Petrucci, K. Spies, Vienna 2014, p. 544.

⁵⁸ P. Sz wajdler, *Jurysdykcja Podatkowa w przypadku działalności gospodarczej w branży e-commerce*, „Journal of Education, Health and Sport” 2017, No. 7, pp. 685–704.

⁵⁹ *OECD/G20 Base Erosion and Profit Shifting Project – Addressing the Tax Challenges of the Digital Economy*, Action 1 2015 Final Report.

⁶⁰ I. Mosquera, V. Lesage, W. Lips, *Tax and Development: The Link between International Taxation, the Base Erosion Profit Shifting Project and the 2030 Sustainable Development Agenda*, "Working Paper Series W-2018/4", United Nations University, pp. 3–32.

⁶¹ www.trtworld.com/business/the-battle-to-tax-big-tech-is-getting-real-32475 (accessed: 11.08.2020).

ambitious actions by imposing a tax on the activities of high technology companies in 2019.⁶² The US government objected, arguing that the taxes as imposed were discriminatory and inconsistent with the global standards. The US went further, threatening Paris with retaliation in the form of tariffs on French products. Admittedly, those arguments – based on the premise that Paris violated the existing tax order – sounded convincing.⁶³ The French also overlooked the fact that their action created a precedent that other countries could levy taxes that are inconsistent with generally accepted global standards. Such a trend could lead to wide-spread chaos and discrimination.

Reforming the current, well-established system presents a serious challenge. Any reform of the model convention would require a departure from the established and widely accepted rules, the creation of alternative mechanisms, wide-spread multinational acceptance of and agreement to the reforms, and then a new reformed network of international treaties. A treaty is effective only if both countries are willing to sign it.⁶⁴ Unfortunately, countries such as Ireland and Luxembourg, considered by many to be tax havens, are not interested in changing the *status quo* because they are benefiting under the current regime – at the expense, unfortunately, of other countries.⁶⁵ Because Big Tech companies are much more mobile than their predecessors, it is not enough to amend one treaty, since such companies can easily change their place of residence for tax purposes by relocating their servers and IP locations.⁶⁶ Such reforms also raise political questions – evidenced by the reaction of the US in the example given above. Countries that would be motivated to make such objections also have the economic power to block any tax initiative deemed unfavorable to their taxpayers.⁶⁷

One alternative to bilateral action is the development of reforms by international organizations. It would seem that organizations with a high degree of credibility and influence, such as the EU, would be better placed to develop effective solutions and force their application through the economic and political power of their

⁶² www.france24.com/en/20200122-us-french-tax-truce-a-respite-in-tense-relations-with-eu (accessed: 11.08.2020).

⁶³ R. Mason, L. Parada, *Digital Battlefield in the Tax Wars*, “Virginia Law and Economics Research Paper”, No. 2018–16.

⁶⁴ E. Wyrasz, *The application of international conventions and treaties to third states*, “Czech Yearbook of International Law Volume” 2017, No. 7, pp. 387–401.

⁶⁵ P. Dietsch, *Catching capital: The ethics of tax competition*, New York 2015, p. 33.

⁶⁶ J. Gałuszka, *How to Tax E-commerce – Global or National Problem?* “Studia Ekonomiczne” 2013, nr 150, pp. 193–202.

⁶⁷ Ch. Giles, D. Crow, *US threatens to slap tariffs on British cars*, FT, January 23, 2020, p. 2, paper issue.

member states and through soft law mechanisms.⁶⁸ However, this has not proven to be the case, so some organizations are considering more proactive approach toward global reforms.⁶⁹

Tax sovereignty is considered to be a very important aspect of national sovereignty.⁷⁰ This is one of the main reasons why there has been so little success in establishing even a foundation of a new global tax order.⁷¹ However, global taxation proposals are emerging with increasing frequency, especially when compared to other attempts at globalized regulations, such as those relating to climate change.⁷² It is recognized that international organizations such as the OECD have made significant achievements in creating and promoting tax solutions on a global scale. One example of this is the wide use of the OECD transfer pricing rules.⁷³ Also, the BEPS project proved to be moderately successful (although final judgment should be reserved until the project is completed). We have discovered that, when it comes to a global tax regime, quick changes are more difficult to implement and that the process of gradual acceptance of global transfer pricing rules proved to be a more effective means of implementation.⁷⁴ The OECD is currently working on developing a new international tax framework with relation to e-commerce taxation and must consider a wide range of solutions in order to achieve acceptance. Such considerations range from the creation of a new definition of PE that would incorporate the e-commerce business model to adopting the FA approach to create a completely new digital tax based on the allocation of the corporation's global profits to individual countries with reference to agreed-upon factors.⁷⁵

The result of the OECD's work must necessarily reflect a series of compromises that address a range of national interests. These could include a country's budgetary income, the interests of those countries that may want to block any given set of reforms (as we have seen in other contexts with the US and China, for instance) and the inte-

⁶⁸ M. Greggi, *How Goes the Night, Commissioner? Some Considerations on the Digital Tax Proposal*, Project for European Commission (2017-1-LI01-KA203-000088).

⁶⁹ H.P. Pistone, *Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy*, "WU International Taxation Research Paper Series" 2015, No. 15, pp. 1–63.

⁷⁰ M. Motala, *The New Global Politics of sovereign international tax: Space, time and why BEPS is not the final frontier*, "Banking and Finance Law Review" 2018, pp. 363–411.

⁷¹ S. Davidson, Ch. Berg, *Submission to the Senate Inquiry into Corporate Tax Avoidance Institute of Public Affairs 2015*. Obtained from: www.ipa.org.au, p. 18 (accessed: 16.03.2020).

⁷² K. Zhang, Q. Wang, Q. Liang, H. Chen, *A bibliometric analysis of research on carbon tax from 1989 to 2014*, "Renewable and Sustainable Energy Reviews" 2016, No. 58, pp. 297–310.

⁷³ A. Vega, *International governance through soft law: The case of the OECD transfer pricing guidelines*, "TranState Working Papers" 2012, No. 163, Univ., Staatlichkeit im Wandel, Bremen, pp.1–30.

⁷⁴ S. Rocha, *The Other Side of BEPS: "Imperial Taxation" and "International Tax Imperialism"*, [in] *Tax Sovereignty in the BEPS Era*, eds. S.A. Rocha, A. Christians, Alphen aan den Rijn 2017, p. 189.

⁷⁵ See: *Addressing the Tax Challenges of the Digital Economy*, OECD Publishing, Paris, 2014, pp. 143–155.

rests of developing countries, which are considered to be short-changed under the current global tax system. The consent of Big Tech companies must also be sought, since they have significant lobbying strength. It should be noted that the OECD does not have any actual authority or power over states or taxpayers. Member states can consider the organization's pronouncements to be non-binding; the OECD has no power to impose legal sanctions. The strength of this organization lies solely in its respectability and the approach that it has used for decades – soft law.⁷⁶

De lege ferenda postulates

With the increasingly rapid changes to the way that we do business, the world must be ready to face new challenges. One of these challenges is the development of new tax principles. The problem extends beyond e-commerce taxation, and the new solutions will affect the future of taxation globally.⁷⁷ Legal standards should not be created without a flexible mechanism for extension and adaptation to changes in the business environment.

The network of treaties, although it constitutes the foundation of the existing international tax order, presents a serious obstacle to a quick and effective global response to the challenges presented, and it appears as though a completely new set of rules which can gain broad international acceptance may be needed. The challenge presented is not only the creation of a set of new mechanisms, but (more importantly) the internationalization of any such rules.

Undertakings by international organizations have been discouraging up until now, and even the EU supported measures have been disappointing. This leads to the conclusion that there will be little, if any, progress in the development of any international tax reform without wide-spread international cooperation. One way that this could be done is for the various countries to cede part of their tax sovereignty to an international body that would be appointed to be responsible for the taxation of such companies.⁷⁸

As the IMF points out, this could lead to an actual increase in budget revenues of many countries (through the global taxation of presently non-taxable income).⁷⁹

⁷⁶ J. Chaisse, X. Ji, *Soft law in international law making: How soft law is reshaping international economic governance*, "Asian Journal of WTO Law and Health Policy" 2018, No. 13, pp. 463–477.

⁷⁷ D. Liu, J. Reyneveld, C. Straatman, *International – OECD's Work on the Digital Economy: Impact Far beyond the Digital Economy*, "International Transfer Pricing Journal" 2019, No. 5.

⁷⁸ R. Azam, *The Political Feasibility of a Global E-commerce Tax*, "University of Memphis Law Review" 2013, No. 43, pp. 2–57.

⁷⁹ See: *Supporting the Development of More Effective Tax Systems. A Report to the G-20 Development Working Group by the IMF, OECD, UN and WORLD BANK*, p. 8.

Such a body could evolve into an *International Tax Organization* – possibly, a future global taxing body.⁸⁰

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⁸⁰ A.J. Cockfield, *The rise of the OECD as informal world tax organization through national responses to e-commerce tax challenges*, "Yale Journal of Law and Technology" 2006, No. 8, pp. 136–187.

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