UNIVERSITY OF LISBON

SCHOOL OF LAW

THE NEW PERMANENT ESTABLISHMENT: CONSEQUENCES OF THE MLI ON THE OECD MODEL CONVENTION AND PORTUGUESE DOUBLE TAX TREATIES – BEPS' AFTERSHOCKS

TIAGO MANUEL GONÇALVES MARQUES

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"It is only through labor and painful effort, by grim energy and resolute courage, that we move on to better things"

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ABSTRACT

The PE is a century-old concept with a fundamental role in the international taxation system via the fair allocation of taxing rights over cross-border business profits within the source-residence principles equilibrium, as a vital threshold for source taxation. Throughout its existence, this pivotal element has relied on its founding principles, which are set on physical presence.

The BEPS advent raised public awareness over the global inertia against MNEs' BEPS tax planning and elusion practices employed across the spectre of the international tax system, including within the PE concept, where they sought the avoidance of PE status in source countries through artificial means.

Therefore, a resounding change to the international taxation system was required to address the issues identified, as there was a need for a profound global paradigm shift towards global tax planning events since unilateral measures are ineffective towards global acting players, such as MNES, instead, such unilateral actions could cause additional tax planning opportunities.

The BEPS Project sparked tumultuous times in international taxation as it was necessary to amend and improve it, including the PE concept. The global economy and MNEs' tax planning practices had evolved, and the international taxation system failed to accompany both.

Regarding the PE concept, its framework remained mostly unchanged for fifty years, which revealed significant difficulties towards newer business endeavours and tax planning opportunities, thus amendments were required. Part of the PE concept's elements were placed under the spotlight for modification to prevent the artificial avoidance of PE status.

The BEPS Project set off a series of chain reactions, first with the prime device for the immediate implementation of this undertaking's solutions, the MLI, which was expected to deliver results swiftly and harmoniously, and yet, it may have fallen short on its objective thus far.

The following reaction came with the OECDMC update, in an attempt to complement the MLI's implementation efforts of the BEPS Project's PE solutions across the global DTT network.

Considering the unrest around the PE concept, it matters to focus on its future in the BEPS' quake and aftershocks' aftermath, where we find that the PE concept's traditional configuration is still a crucial element of the international taxation system and it should be preserved and improved. Embracing its founding principles, rather than be mauled and transfigured into a hybrid multipurpose tool with questionable viability and effectiveness.

This work aims at humbly researching the PE concept based on its pre-BEPS reality and critically analysing the amendments introduced following the BEPS Project, adding to the discussion around the traditional PE concept in a time where the general focus lies in either the attribution of profits to PEs or digital taxation based on the PE and less on the PE concept itself.

Key Words: New Permanent Establishment, Post-BEPS, MLI, OECD Model Convention, Portugal.

RESUMO

O estabelecimento estável é um conceito centenário que desempenha desde a sua génese um papel primordial no âmbito do sistema fiscal internacional através da justa repartição do direito de tributar lucros transfronteiriços no contexto do ténue equilíbrio entre os princípios da residência e da fonte, enquanto limiar essencial para a efectiva tributação na fonte.

Ao longo da sua existência, este elemento vital do sistema fiscal internacional tem-se sempre pautado de acordo com os princípios estruturantes que regeram o seu desenvolvimento, os quais assentam na presença física.

A erosão de bases tributárias e a transferência de lucros, ou BEPS, é um vírus que há muito assola o sistema fiscal internacional e tem nas empresas multinacionais, ou MNEs, o principal utilizador e beneficiário, maioritariamente devido à facilidade com que desenham e implementam mecanismos de planeamento fiscal internacional, legais ou não, através dos quais colhem importantes vantagens fiscais, como a redução ou ausência de tributação, gerando danos para a generalidade dos contribuintes e dos Estados.

Não obstante o planeamento fiscal agressivo e a elisão e evasão fiscal não serem fenómenos recentes ou desconhecidos do sistema fiscal internacional, o mesmo não se poderá dizer em relação à dimensão e alcance que estas práticas atingiram na última década, em especial através da interpretação criativa de conceitos por forma a atribuir uma aparente legalidade à estratégia fiscal ou através da exploração de ineficiências decorrentes da interacção entre ordenamentos jurídicos.

Com o advento do BEPS, fruto da crise financeira global, a generalidade do público tomou conhecimento da práctica enraizada destas estratégias, bem como da inércia global contra tais práticas implementadas ao longo de todo o espectro do sistema fiscal internacional. Estas estratégias foram implementadas em todo o sistema fiscal internacional como uma praga vasta, que deve ser rápida e eficazmente erradicada em toda a sua extensão, desconsiderando preocupações de moralidade fiscal.

Enquanto conceito fundamental no sistema fiscal internacional, o estabelecimento estável foi um dos conceitos explorado por empresas

multinacionais para obterem benefícios indevidos, nomeadamente através do uso de mecanismos artificiais para evitarem a qualificação como estabelecimento estável no Estado da Fonte e assim obstarem à tributação sobre os lucros ali obtidos.

É neste contexto tumultuoso e reactivo contra estas prácticas que a nossa investigação ao conceito de estabelecimento estável se centra, no apuramento do conceito existente à data deste advento e das suas fragilidades, por forma a melhor compreender as causas destas práticas e as soluções apresentadas para as erradicar e prevenir.

Em virtude das extensas fragilidades do sistema fiscal internacional e do alcance das práticas das empresas multinacionais, era necessária uma mudança de paradigma à escala global profunda para abordar estas estratégias, pois medidas unilaterais são ineficazes perante actores globais, aliás, tais acções unilaterais podem criar oportunidades de planeamento fiscal e assim eternizar o problema.

Perante eventos extraordinários é necessário adoptar medidas extraordinárias, e é precisamente neste contexto único que surge o Projecto BEPS, um projecto pioneiro com um objectivo concreto de atacar estas práticas, que desencadeou tempos tumultuosos no sistema fiscal internacional com o propósito de o alterar e melhorar, incluindo no conceito de estabelecimento estável.

A economia global e as estratégias das empresas multinacionais evoluíram e o sistema fiscal internacional não as acompanhou, causando assim um perigoso desfasamento entre as suas soluções e as novas realidades de actividades empresariais.

Relativamente ao conceito de estabelecimento estável, o seu enquadramento permaneceu maioritariamente inalterado durante cinquenta anos, revelando dificuldades significativas perante novas actividades empresariais e estratégias de planeamento fiscal, necessitando de modificações.

Neste sentido, dentro do Projecto BEPS surge a Acção 7 que coloca em evidência certos elementos deste conceito para serem modificados de forma a que as estratégias que visavam a elisão artificiosa da qualificação como estabelecimento estável fossem erradicadas e novas estratégias similares prevenidas.

Tal como o nosso estudo, a Acção 7 parte do conceito de estabelecimento estável existente à data na Convenção Modelo da OCDE, que estava particularmente

vulnerável às prácticas implementadas, e desenvolve um conjunto de soluções específicas para determinados elementos desenhadas com o propósito de melhorar este conceito ao mesmo tempo que diminui o limiar para a constituição de um estabelecimento estável no Estado da Fonte, tornando assim impermeável a estas prácticas.

As referidas normas concentraram-se em torno de 3 elementos essenciais deste conceito, o estabelecimento estável de agência, em que foca nos comissionistas e no estatuto de agente independente e o uso abusivo desta figura por entidades estreitamente relacionadas; as actividades preparatórias e auxiliares, nomeadamente nas prácticas de fragmentação de actividades coesas; e no estabelecimento estável de construção, na vertente de segregação de contractos.

Tendo identificado o contexto em que se insere a revolução proposta sobre o conceito de estabelecimento estável, a nossa investigação visa analisar criticamente as soluções propostas pelo Projecto BEPS através da Acção 7 e apresentar soluções alternativas onde aquelas não são satisfatórias, o que ocorre com frequência, em especial devido à falta de medidas que diminuam adequadamente os efeitos laterais causados pelas medidas sugeridas e às opções dadas aos Estados que fomentam prácticas divergentes.

Além de ser caracterizada por uma notória despreocupação com os efeitos secundários das soluções propostas, a Acção 7 também poderá sê-lo por evidenciar uma dúbia relação das suas soluções com a artificialidade e abuso das prácticas que visa combater, ao invés aparenta uma maior preocupação com o fim a atingir do que com os meios empreendidos, denotando um ataque cego ao planeamento fiscal, seja ele legitima e legal ou não.

A Acção 7 causou, e foi, um autêntico terramoto no conceito de estabelecimento estável, propondo diversas modificações ao conceito de estabelecimento estável, criando assim um novo conceito. Contudo, não basta propor medidas, é necessário que estas sejam aceites e implementadas para que o resultado pretendido seja atingido.

Na sequência do sismo inicial, diversas réplicas surgiram, as quais procuraram a implementação das suas medidas de forma rápida, harmoniosa e coordenada ao longo da rede global de Convenções de Dupla Tributação, pois só assim seria

possível prevenir a elisão artificiosa da qualificação como estabelecimento estável e de tributação na fonte.

A primeira réplica foi a Convenção Multilateral, ou MLI, uma suposta inovadora maravilha jurídico-fiscal e um primeiro passo fundamental em direcção à multilateralidade no contexto do sistema fiscal internacional, cujo propósito é a célere, coordenada e coerente implementação das soluções propostas pelo Projecto BEPS na rede global de Convenções de Dupla Tributação, onde se inserem as referentes ao conceito de estabelecimento estável.

Todavia, o objectivo desta réplica depende naturalmente da vontade soberana dos Estados, enquanto instrumento de Direito Internacional Público, o que poderá dificultar a concretização de tal objectivo, em especial considerando a ampla flexibilidade atribuída ao Estados, o que, até à data, se tem efectivamente verificado em relação às medidas referentes ao conceito de estabelecimento estável, onde a adesão não é satisfatória. Adicionalmente, como abordaremos em detalhe, a Convenção Multilateral absteve-se de abordar as limitações identificadas às soluções da Acção 7, sendo um mero instrumento de reprodução e tentativa de implementação.

A segunda réplica surge com a actualização da Convenção Modelo da OCDE em linha com as soluções propostas no âmbito do Projecto BEPS, o que implica também a alteração do conceito de estabelecimento estável presente no seu artigo 5.º. esta actualização é uma decorrência natural do Projecto BEPS e apresenta-se também com uma ajuda mediata ao esforço da Convenção Multilateral em atingir a implementação de forma coerente e coordenada, um instrumento focado nas Convenções de Dupla Tributação em vigor e o outro nas que serão negociadas e ainda entrarão em vigor.

Novamente, poucas melhorias existiram às soluções propostas pela Acção 7, porém a OCDE ainda assim aproveitou a oportunidade apresentada para introduzir alguns melhoramentos ao conceito de estabelecimento estável além da Acção 7, como criticamente analisaremos.

Ultrapassadas as principais réplicas internacionais, a nossa investigação abordará brevemente o sistema fiscal português em busca de uma réplica, ainda que de menor dimensão, no âmbito do conceito de estabelecimento estável português,

analisando tanto na esfera internacional como na esfera doméstica este conceito e a sua relação com a Acção 7.

Por fim, no rescaldo destes sismos e considerando a agitação em torno do conceito de estabelecimento estável, importa focar no seu futuro, onde constatamos que a configuração tradicional deste conceito ainda é um elemento essencial do sistema fiscal internacional e deve ser preservado e melhorado, respeitando os seus princípios estruturantes, em vez de ser mutilado e transfigurado num instrumento híbrido polivalente com viabilidade e eficácia questionáveis.

Numa altura em que cada vez mais o foco de discussão académica e técnica se encontra monopolizada pelos temas da imputação de lucros a estabelecimentos estáveis de acordo com as directrizes e orientações de preços de transferência e a tributação da economia digital, pretendemos com esta modesta investigação recuperar e abordar o conceito de estabelecimento estável, enquanto base instrumental do sistema fiscal internacional, comumente esquecida particularmente em Portugal, e sem a qual, pelo menos parte, das demais investigações e estudos teriam reduzida utilidade, quer teórica quer prática.

Palavra-Chave: Novo Estabelecimento Estável, Pós-BEPS, MLI, Convenção Modelo OCDE, Portugal.

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LIST OF ABBREVIATIONS

2014 OECDMC	OECD Model Tax Convention on Income and Capital 2014 version
2017 OECDMC	OECD Model Tax Convention on Income and Capital 2017 version
BEPS	Base Erosion and Profit Shifting
BEPS Project	OECD/G20 Base Erosion and Profit Shifting Project
DAPE	Dependent agent Permanent establishment
DTT(s)	Treaty(ies) for the Avoidance of Double Taxation or Double Taxation Treaty(ies)
E.g.	*Exempli gratia*
Ed(s).	Editor(s)
Et al.	*Et alia*
EU	European Union
FPOB	Fixed place of business
G20	Group of Twenty
I.e.	*Id est*
Ibid.	*Ibidem*
LRD(s)	Low-risk distributor(s)
MLI/Multilateral Instrument	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
MNE(s)	Multi-national enterprise(s)
OECD	Organization for Economic Co-operation and Development
OECDMC	OECD Model Tax Convention on Income and Capital
OECDMC Commentary/ Commentary	OECD's Committee on Fiscal Affairs Commentary on the OECDMC

P.	Page
Para.	Paragraph
PE(s)	Permanent establishment(s)
Pp.	Pages
UK	The United Kingdom of Great Britain and Northern Ireland
UN	The United Nations
UNMC	UN Model Double Taxation Convention Between Developed and Developing Countries
USA	The United States of America
VCLT	Vienna Convention on the Law of Treaties
WP1	OECD's Committee on Fiscal Affairs' Working Party No. 1 on Tax Conventions and Related Questions

INTRODUCTION

International taxation is amongst the most fundamental elements of the global economy as we know it today, playing a crucial role in the fair allocation of taxing rights, effective taxation where income is deemed to exist and on the prevention of double taxation and non-taxation, the latter more recently, which, all combined, allow and foster the existence of a global trade economy.

Within the international taxation system, the PE concept is a decisive legal construction that regulates the allocation of taxing rights over cross-border business profits between countries. As a corollary of the residence and source principles, this concept has the notorious function of being these principles' equilibrium by drawing a portion of business profits to source taxation, based on effective and sufficient economic presence.

It is well-known that the international taxation system is in a state of turmoil with the advent of BEPS activities, a proliferation of (abusive) tax planning, resolute scrutiny and greater public awareness over tax planning strategies, an exacerbated morality in taxation and strenuous demands for fair and sufficient taxation.

Opening this Pandora box fast-forwarded remarkable work on the international taxation system by international organizations and most of the world's countries, in the form of the BEPS Project and its holistic endeavour to improve and strengthen the international taxation system against BEPS practices.

The PE concept shares this state of turmoil, particularly relevant for an ancient legal instrument that had been lacking sufficient work and updates to continue to conduct its essential role in the current global, and increasingly digital, economy.

One of the BEPS Project's branches, Action 7, was devoted to the PE concept and the prevention of the artificial avoidance of PE status, which proposed solutions that ought to be steadily, swiftly and harmoniously implemented throughout the international taxation system, especially across the countries' DTT networks.

Action 7 marks the epicentre of the most significant work conducted on the PE concept in recent years, triggering a sequence of noteworthy events of similar

magnitude, resulting in a pinpointed PE concept reform, the outcome of which is still lingering in limbo between success and failure.

While Action 7 is the epicentre of the PE concept's havoc, its cause can be traced back to this concept's version prior to Action 7's revelation, as perfect evidence of a once magnificent ship adrift in the seas of time, forgotten and poorly taken care of.

The dawning of the digital economy and growing dematerialization took a toll on the PE concept and its physical presence core, as it failed to accompany such event, and this concept's primary caretakers failed to address it, and its pre-existing conditions, properly.

Therefore, it was necessary to quickly improve and upgrade the PE concept for it to keep on executing its functions effectively and accurately as the primal mechanism for the allocation of taxing rights over cross-border business profits.

Action 7 arises in this context with a seismic presence that reverberates across the international taxation system, sparking the first aftershock with the need to immediately implement its work through the MLI, a unique venture in its own right. Subsequently, a second reverberation was sensed, this time within the OECDMC, which was amended per the BEPS Project, including the PE concept's amendments.

Together with macro events across the international taxation system, other feeble quakes were expected, through modifications to the countries' domestic PE concept, for instance in Portugal.

After this havoc, when the dust finally sets, it is paramount to focus on the PE concept's future and continuous improvement as a quintessential element of the international taxation system that dons a unique international nature.

Instead of accompanying the harbingers of the PE concept's demise, this thesis diverges and focuses instead on comprehending, salvaging and continuing to improve it.

A. SCOPE AND PURPOSE

Despite the digital economy's advent and its steady evolution, the traditional economy, where physical presence thrives, still overshadows it, therefore it is

imperative that academic and intellectual discussions and research can see the forest for the trees and does not fall on Parkinson's Law of Triviality.

Surely that the digital and dematerialized economy will have a significant share in the global economy and that this is a new, and mostly, baffling, reality to which the international taxation system and its stakeholders have thus far failed to grasp and address properly, yet, the PE concept should not be transfigured and grafted with dubious solutions as a first-aid solution to this complex reality.

It can hardly be said that physical presence will become trivial; it is and shall continue to be, an important aspect of international trade and the global economy. As such, the international taxation system's elements that connect with it, like the PE concept, must keep being a relevant and frequent part of academic and intellectual discourse, pushing for innovation and continuous improvement to limit and eradicate deficiencies. Even more so when considering recent events, which showcase that physical presence in global business is a need and will be a constant.

Furthermore, the PE concept itself lacks contemporary effective discussion amongst academic circles and proper investigation and research, with the majority of the current emphasis placed on the effective allocation of taxing rights and its methods, and transfer pricing. However, both kinds of research hinge on the prior existence of a PE, its nuances, particularities and concepts.

In this sense, we sought to investigate the PE concept, while respecting its physical presence roots, to foster academic research over this legal construction and to provide a humble contribution to its continuous growth and improvement, while, at the same time, potentially providing context for connected researches.

This thesis will be dedicated to International Taxation Law and focused on the international taxation system’s aspects of the PE concept, more specifically on the OECDMC, notably on article 5 OECDMC, while embracing and following the PE concept's heritage and foundational principles.

We will assess and critically analyse the PE concept’s evolution from the 2014 OECDMC to its current stage following Action 7's influence and the modifications perpetrated by the MLI and the 2017 update to the OECDMC, with a dedicated commentary to the Portuguese situation, as well as our glimpse onto the PE concept's future.

Our work will not enter into considerations over EU law or other regional systems' aspects, nor general domestic systems, other than the strict Portuguese comments referred.

Also, for the sake of conciseness and overall scope and purpose, this thesis will not address triangular/third country PE situations, nor the conundrums connected with the diverse proposals for a digital PE, nor the particularities connected with the optional service PE and those of the electronic commerce, despite incidental references. Likewise, our thesis shall not address the effective allocation of taxing rights and their methods, nor transfer pricing aspects, instead, it focuses on the PE concept itself.

Lastly, all references included herein, legal or otherwise, are updated until September 9th, 2021.

B. STRUCTURE

Following this introduction, which entails the core aspects and the purpose of this thesis, and some preliminary observations that provide operative concepts for better comprehension of our work, Chapter 1 undertakes to expose the foundation of our research, by introducing and detailing the PE concept as per article 5 2014 OECDMC.

In Chapter 2, we board the BEPS Project and Action 7, as the trigger for the PE concept's modifications, where we present and critically analyse the PE concept's proposed amendments, commending its merits and presenting solutions for its profuse downfalls. Chapter 3 comes as a natural consequence, as it deals with the PE concept within the MLI, which serves as the primal tool for implementing Action 7's solutions for the PE concept, where we depict and assess the MLI's part IV and evaluate its acceptance and connection with Action 7.

The BEPS Project's subsequent aftershock on the PE concept is the 2017 update to article 5 OECDMC, whose analysis and critical assessment is undertaken in Chapter 4, where we showcase the new article 5 OECDMC and focus on the improvements and amendments perpetrated vis-à-vis article 5 2014 OECDMC, thus

concluding our critical assessment of the PE concept's international aspects and evolution connected with Action 7's prevention of the artificial avoidance of PE status.

Chapter 5 will take on the Portuguese PE concept's assessment, starting with its current DTT status and freshly amended domestic concept, advancing onto its near future and assessing Portugal's stance on the PE concept's international aftershocks.

Finally, we conclude this thesis with Chapter 6, which encompasses our vision for the PE concept's future as well as solutions and proposals for its continuous improvement.

For better comprehension, we will include in each chapter a section with the preliminary conclusions that can be drawn from our work therein.

C. PRELIMINARY OBSERVATIONS

a) Tax Sovereignty and DTTs

A country's sovereignty can be exhibited through various means, one of which is taxation. Although taxation is an example of a country's sovereignty, in present times, taxation is becoming increasingly limited and shared. One of such examples is the willing limitation countries place on themselves when negotiating and concluding DTTs, a country's power that results from its taxation sovereignty[1].

As tax sovereign entities, countries may impose taxation on persons[2] connected with themselves or place limits on their taxation powers, such as concluding DTTs[3].

[1] DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax Competition and the BEPS Concept of Permanent Establishment*. EC Tax Review. Volume 25, number 5/6 (2016) p. 298; BRAVO, Nathalie – *Chapter 1: Tax Treaties for the avoidance of Double Taxation on Income and Capital* In *A Multilateral instrument for Updating the Tax Treaty Network*. Books IBFD. 2020. p. 2; SANCHES, J. L. Saldanha – *Manual de Direito Fiscal*. 3rd edition. Coimbra: Coimbra Editora. 2007. p. 80; PIRES, Rita Calçada – *Manual de Direito Internacional Fiscal*. Coimbra: Almedina, 2018. p. 21.

[2] For ease of reference throughout our work, we adopt the expression "person" as defined in article 3 OECDMC to refer to legal and natural persons or other entities.

[3] MACHADO, Jónatas E. M.; COSTA, Paulo Nogueira da – *Manual de Direito Fiscal: perspetiva multinível*. 3rd edition. Coimbra: Almedina, 2019. pp. 177, 192; SANCHES, J. L. Saldanha – *Manual de Direito…* pp. 78, 81; PIRES, Rita Calçada – *Manual de Direito*… p. 21.

However, as per article 2 of the Charter of the UN[4], countries are all equal, hence they may not impose their rules and rights on third states unilaterally[5]. Nonetheless, through a DTT a country may enforce some of its tax sovereignty over another country and the persons connected with it[6].

In this sense, DTTs showcase a country's taxation sovereignty while also being a vessel for the limitation and sharing of said country's right to tax. A DTT may also be a mechanism against outside forces that target the right to tax of a relevant country, *e.g.*, erosion of taxation[7]. At the same time, a DTT offers greater certainty in both countries regarding taxation and may lead to a boost in a country's tax revenue by nurturing cross-border ventures without heightened tax concerns, together with a fair allocation of taxing rights[8].

There has been a considerable increase in the conclusion of DTTs throughout the world with more and more countries reaching agreements on the regulation and split of their taxing rights over the income perceived from persons sufficient linked to them, resulting in over 3500 DTTs in force[9]. Although multilateral tax treaties have become a recent focus, countries still rely on bilateral DTTs to regulate and share taxing rights over income, both active and passive income.

Traditionally, DTTs are concluded between two countries with significant ties, usually, trading and economic ties, which seek to provide further certainty and remove potential tax barriers to persons from both countries when investing in the other country, especially double taxation[10]. Lasting negotiations tend to characterize this process.

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[4] UN – *Charter of the United Nations and Statute of the International Court of Justice*. San Francisco, 1945. Available at: https://treaties.un.org/doc/publication/ctc/uncharter.pdf
[5] BRAVO, Nathalie – *Chapter 1: Tax*… p. 1.
[6] As per article 34 VCLT.
[7] DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 298; HOLMES, Kevin – *Chapter 3: Double Tax Treaties* In *International Tax Policy and Double Tax Treaties – An Introduction to Principles and Application*. Second Revised Edition. Books IBFD. 2014. pp. 1-2.
[8] RIBEIRO, Cláudio de Paiva – *A tributação do estabelecimento estável na economia global e digital: uma análise jurisprudencial em Portugal*. 2018. Coimbra. Master thesis. p. 19; BRAUNER, Yariv – *Treaties in the Aftermath of BEPS*. Brooklyn Journal of International Law. Volume 41, issue 3 (2016) p. 985; MACHADO, Jónatas E. M.; COSTA, Paulo Nogueira da – *Manual de Direito…* pp. 182, 323; MAISTO, Guglielmo [et. al.] eds. – *New Trends in the Definition of Permanent Establishment*. Volume 17 of EC and International Tax Law Series. Books IBFD. 2019. p. 199.
[9] BRAVO, Nathalie – *Chapter 1: Tax*… pp. 2-3; BRAUNER, Yariv – *Treaties in the*… p. 975.
[10] BRAUNER, Yariv – *Treaties in the*… pp. 975, 985; BRAVO, Nathalie – *Chapter 1: Tax*… p. 2; HOLMES, Kevin – *Chapter 3: Double*… pp. 1-2; MACHADO, Jónatas E. M.; COSTA, Paulo Nogueira da – *Manual de Direito…* p. 182.

Upon the agreement between both countries on the DTT's terms, an international agreement under public internal law will be concluded, yet, it still is necessary for each country to give the DTT proper legal effect within its own legal order[11].

In negotiations, it is customary for countries to rely on a draft DTT and start negotiations from there, such draft DTT tends to follow one of the DTT models in existence, such as the OECDMC[12] or the UNMC[13], predominantly the former[14].

Customarily, developed countries follow the OECDMC while developing countries opt to steer closer to the UNMC[15]. Portugal has traditionally been aligned with the OECDMC[16].

As our work focuses on the PE concept within the OECDMC, a leading reference in international taxation[17], we will enter into more detail over it in the following section.

b) The OECDMC and its Commentary

The OECDMC has long been regarded as a landmark in the international taxation panorama. A wide variety of countries rely on its framework and Commentary when negotiating and applying DTTs and even the UNMC is based on it, as a pro-developing countries spin-off[18].

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[11] HOLMES, Kevin – *Chapter 4: Legal Framework of Double Tax Treaties* In *International Tax Policy and Double Tax Treaties – An Introduction to Principles and Application*. Second Revised Edition. Books IBFD. 2014. p. 1; MACHADO, Jónatas E. M.; COSTA, Paulo Nogueira da – *Manual de Direito…* pp. 183-184.

[12] OECD Model Tax Convention on Income and on Capital, currently in force the 2017 updated version.

[13] UN Model Double Taxation Convention between Developed and Developing Countries, currently in force the 2017 updated version.

[14] HOLMES, Kevin – *Chapter 4: Legal*… p. 1; DOURADO, Ana Paula – *Governação Fiscal Global*. Coimbra: Almedina, 2017. pp. 28-29.

[15] BRAVO, Nathalie – *Chapter 1: Tax*… p. 7; HOLMES, Kevin – *Chapter 3: Double*… pp. 4-5; XAVIER, Alberto – *Direito Tributário Internacional*. 2nd edition updated. Coimbra: Almedina, 2009. p. 101.

[16] XAVIER, Alberto – *Direito Tributário Internacional*… pp. 105-112.

[17] BRAUNER, Yariv – *Treaties in the*… p. 977.

[18] BRAUNER, Yariv – *McBEPS: The MLI – The First Multilateral Tax Treaty that Has Never Been.* Intertax. Volume 46, issue 1 (2018) p. 7; MACHADO, Jónatas E. M.; COSTA, Paulo Nogueira da – *Manual de Direito…* p. 194; SANCHES, J. L. Saldanha – *Manual de Direito…* p. 81; DOURADO, Ana Paula – *Governação Fiscal Global*… pp. 28-29.

The OECDMC is not itself an international treaty, it serves as a model based on which countries can develop their draft DTTs and eventually conclude a DTT[19]. In a DTT's concluding process, as the relevant countries are not bound by the OECDMC, the final DTT may deviate from its framework, as per the countries' will[20].

Similarly, the OECDMC Commentary is non-binding towards countries concluding DTTs, just like they are not binding on domestic courts and tax administrations, yet, they have been proven to be valid elements of interpretation, even though their role in the interpretation of tax treaties and position under public international law is controversial[21].

The OECDMC's genesis dates back to 1963 and the OECD's initial works, which started with its creation in 1961, following the work commenced by its predecessor on the elimination of double taxation and also the works of the League of Nations at the beginning of the XIX century[22]. With effect, in 1963 the world met the first OECDMC and its Commentary, an interpretative element of the OECDMC's framework.

Ever since then, the OECDMC and its Commentary have been routinely revised and updated to keep up with the world's development, both economically and scientifically[23].

The OECDMC's framework includes rules on the scope of and qualification for the DTT's benefits, rules on the allocation of taxing rights concerning taxes on income and capital, and rules on the elimination of double taxation.

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[19] XAVIER, Alberto – *Direito Tributário Internacional*… p. 99; MACHADO, Jónatas E. M.; COSTA, Paulo Nogueira da – *Manual de Direito…* p. 192.

[20] HOLMES, Kevin – *Chapter 3: Double*… p. 5; VEGA, Alberto – *Chapter 2: The Legal Status and Effects of Reservations, Observations and Positions to the OECD Model* In MAISTO, Guglielmo ed. – *Departures from the OECD Model and Commentaries: Reservations, observations and positions in EU law and tax treaties*. Volume 11 in the EC and International Tax Law Series. Books IBFD. 2014. p. 2.

[21] XAVIER, Alberto – *Direito Tributário Internacional*… pp. 152-153; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral: Enquadramento e Impacto nas Convenções para Evitar a Dupla Tributação Celebradas por Portugal*. Coimbra: Almedina, 2020. pp. 34-35.

[22] XAVIER, Alberto – *Direito Tributário Internacional*… p. 103; HOLMES, Kevin – *Chapter 3: Double*… p. 4; VASQUES, Sérgio – *Manual de Direito Fiscal*. Reprint. Coimbra: Almedina, 2012. p. 101; DOURADO, Ana Paula – *Governação Fiscal Global*… p. 16; PIRES, Rita Calçada – *Manual de Direito*… p. 137.

[23] XAVIER, Alberto – *Direito Tributário Internacional*… pp. 103-104; HOLMES, Kevin – *Chapter 3: Double*… p. 4; LANG, Michael; BRUGGER, Florian – *The role of the OECD Commentary in tax treaty interpretation*. Australian Tax Forum. Volume 23, number 2 (2008) p. 96; VASQUES, Sérgio – *Manual de Direito…* p. 101.

The OECDMC Commentary serves as an interpretive guide to the intent with which the provisions included in the OECDMC were designed and included therein, as the harmonized understanding of the OECD member countries' tax administrations[24].

Despite the never-ending discussion on the OECDMC Commentary's legal nature, from a practical perspective, they have long been regarded as a valuable interpretative element of the OECDMC and also of the DTTs that closely follow it, especially where the countries involved are OECD members[25].

Considering this thesis' focus, the OECDMC Commentary's relevance for our work stands clear. Furthermore, the OECDMC Commentary are also technical explanations of the OECDMC's provisions that seek to develop the somewhat broad and condensed terms used[26].

Throughout our work, we will rely on the OECDMC Commentary's interpretation and guidance, although we may occasionally deviate from it.

Additionally, countries can make reservations on the OECDMC and these are present in the OECDMC Commentary. A reservation is essentially a country's unilateral statement of disagreement with an OECDMC provision and that it is its intent not to follow such provision in the DTTs it shall conclude[27]. Still, it is important to differentiate the OECDMC's reservations from the proper reservations in international public law, as the OECDMC is not an international treaty[28].

The OECDMC's reservations simply convey a country's position on a specific provision and these are not binding towards other countries, however, these do

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[24] HOLMES, Kevin – *Chapter 3: Double*… p. 4; COURINHA, Gustavo Lopes – *Estudos de Direito Internacional Fiscal*. Lisbon: AAFDL, 2015. p. 16.

[25] XAVIER, Alberto – *Direito Tributário Internacional*… pp. 152-154; HOLMES, Kevin – *Chapter 4: Legal*… pp. 4-5; LANG, Michael; BRUGGER, Florian – *The role of*… pp. 96-100; ERASMUS-KOEN, Monica; DOUMA, Sjoerd – *Legal status of the OECD Commentaries – in search of the holy grail of international tax law*. Bulletin for International Taxation. Volume 61, number 8 (2007) pp. 339-352; VEGA, Alberto – *Chapter 2: The*… pp. 2, 7-9.

[26] XAVIER, Alberto – *Direito Tributário Internacional*… pp. 152-153; MACHADO, Jónatas E. M.; COSTA, Paulo Nogueira da – *Manual de Direito…* p. 193.

[27] LANG, Michael; BRUGGER, Florian – *The role of*… p. 101; SASSEVILLE, Jacques – *Chapter 1: The Role and Evolution of Reservations, Observations, Positions and Alternative Provision in the OECD Model* In MAISTO, Guglielmo ed. – *Departures from the OECD Model and Commentaries: Reservations, observations and positions in EU law and tax treaties*. Volume 11 in the EC and International Tax Law Series. Books IBFD. 2014. p. 1; MACHADO, Jónatas E. M.; COSTA, Paulo Nogueira da – *Manual de Direito…* pp. 193-194.

[28] SASSEVILLE, Jacques – *Chapter 1: The*… p. 1; VEGA, Alberto – *Chapter 2: The*… pp. 1-4.

indicate the expected position of that country during negotiations[29]. It is left to the ability of that country to enforce its reservation during negotiations with other countries, which may or may not be successful[30].

A country's reservation on the OECDMC is linked to its interpretation of the relevant provision, taking into account its national practice, rules and guidance for that provision, as well as its negotiating position with other countries, which may be connected with the nature of the country's economy, as a capital importer or exporter.

Continuing with our preliminary comments on relevant operative concepts, it is imperative to bring some clarity on the crux of our work, the PE concept.

c) The Permanent Establishment Concept

The PE concept has been a constant in the international taxation panorama for over a century and its essence has been kept intact for the most part.

The PE concept's history begins with the early development in the XIX century in Prussia, where it graduated to be first included in a DTT in 1899 in the Prussia-Austro-Hungary DTT, henceforth, the PE concept has always been embraced by countries and international organizations until today, such as the League of Nations, the OEEC, the OECD and the UN[31][32].

The PE concept is amongst the fundamental concepts in international taxation and widely recognized for its relevance, bearing the role of maintaining the delicate equilibrium between two vital international taxation principles, the source principle

[29] SASSEVILLE, Jacques – *Chapter 1: The*… p. 4; VEGA, Alberto – *Chapter 2: The*… pp. 1, 4, 7-8; COURINHA, Gustavo Lopes – *Estudos de Direito*…. pp. 17-18.
[30] LANG, Michael; BRUGGER, Florian – *The role of*… p. 101; COURINHA, Gustavo Lopes – *Estudos de Direito*…. pp. 19-20.
[31] ATANASOV, Atanas – *Permanent establishment 2.0 – is it time for an update?*. 2016. Maastricht. Master thesis. p. 5; SHTROMBERG, Alexandra – *Managing Permanent Establishment Risks in Multinational Enterprises in Post-BEPS Era*. 2019. Espoo. Master thesis. pp. 6-7; KOSTIC, Svetislav V. – *Chapter 3: New Law on Permanent Establishments* In WHEELER, Joanna ed. – *The Aftermath of BEPS*. Books IBFD. 2020. p. 2; PIRES, Rita Calçada – *Manual de Direito*… pp. 66-71.
[32] For a complete and encapsulating analysis of the PE's origin and history, we refer to SKAAR, Arvid Aage – *Permanent Establishment: Erosion of a Tax Treaty Principle*. Boston: Deventer. Kluwer Law and Taxation Publishers. 1991.

and the residence principle, vis-à-vis persons that have residency in a country and that execute significant activities in another country[33].

The source-residence principles equilibrium is pursued through the allocation of taxing rights between two countries with whom a person has a nexus, be it under the source principle or the residence principle[34].

The PE concept works through a threshold, to avoid becoming overbearing onto cross-border businesses and place tax burdens where they might not be justifiable, *e.g.*, a meaningless one-shot operation or transaction[35].

Therefore, the PE will only be triggered and be deemed to exist where its threshold is surpassed by the cross-border business endeavours of the relevant person. The PE concept's threshold is present in article 5 OECDMC in all its glory and multiple nuances.

The surpassing of this threshold bestows upon the Source Country the legal ability to levy taxes on a non-resident person who has been found to be substantially involved in that country's economic life since article 7 OECDMC states that the Residence Country has the exclusive right to tax business profits from persons resident therein unless those persons are deemed to have a PE in the Source Country, in which case there are cumulative taxing rights between source and residence[36].

Yet, the Source Country's newly acquired taxing rights from this threshold's surpassing by the relevant person does not extend to all income that that person perceives and that arises within it[37]. The Source Country's taxing rights only

[33] DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 296; XAVIER, Alberto – *Direito Tributário Internacional*… pp. 306-307; PEREIRA, Paula Rosado – *Princípios do Direito Fiscal Internacional Do paradigma Clássico ao Direito Fiscal Europeu*. Coimbra: Almedina, 2010. pp. 231-232; PEREIRA, Paula Rosado – *O papel do estabelecimento estável no Direito Fiscal Internacional* In FERREIRA, Eduardo Paz; TORRES, Heleno Taveira, PALMA, Clotilde Celorico eds. – *Estudos em Homenagem ao Professor Doutor Alberto Xavier*. Coimbra: Almedina, 2013. pp. 571, 574; BRAUNER, Yariv – *Treaties in the*… pp. 1006-1007; SANCHES, J. L. Saldanha – *Manual de Direito…* p. 355; PIRES, Rita Calçada – *Manual de Direito*… p. 72.
[34] DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 296; PEREIRA, Paula Rosado – *Princípios do Direito*… p. 232; PEREIRA, Paula Rosado – *O papel do*… pp. 571, 574.
[35] PEREIRA, Paula Rosado – *O papel do*… pp. 574-575.
[36] DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… pp. 301, 311; PEREIRA, Paula Rosado – *Princípios do Direito*… pp. 232-233; PEREIRA, Paula Rosado – *O papel do*… p. 574.
[37] PEREIRA, Paula Rosado – *Princípios do Direito*… pp. 232-233.

encompass the business activities that effectively overcame the threshold, meaning those tied with the PE and not all business income derived from that country[38].

The above goes to our initial comments on the frail equilibrium between the source principle and the residence principle, as both are present in the PE concept and place limits on each other within it.

Also, it is important to establish that a person's PE, be it a legal or a natural person, should be understood as an extension of that same person in another country, without having its own legal personality[39].

However, for tax purposes, the PE should be given the same treatment in source countries as a subsidiary or a resident legal company, as set forth by article 24 (3) OECDMC and in connection with the capital import neutrality principle[40].

The sheer importance and magnitude of influence that the PE concept has had throughout its existence is clear, it rose to become an institution of international taxation and an essential element of every DTT in force, one that is prone to discussions[41].

Notwithstanding, giving its age and considerable aversion to an overhaul, it begs to wonder if this ageing concept still is as important in the current world and economy as it once was, or if it has seen its glory days and should be rethought.

As we will see, the answer to this question is not straightforward and perhaps the right answer is the less obvious one. Without revealing our position, we uphold that the PE concept, true to its core foundational framework, still has an important role to play and to keep on playing.

Considering our work's scope, we will critically analyse and explain article 5 2014 OECDMC and the PE concept on different levels, followed by the aftershocks brought about by the BEPS Project and their aftermath.

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[38] *Ibid*.
[39] XAVIER, Alberto – *Direito Tributário Internacional*… pp. 323-332; PEREIRA, Paula Rosado – *Princípios do Direito*… p. 235.
[40] PEREIRA, Paula Rosado – *Princípios do Direito*… pp. 234-235; PEREIRA, Paula Rosado – *O papel do*… pp. 574, 580-581.
[41] SANCHES, J. L. Saldanha – *Manual de Direito…* p. 356; PIRES, Rita Calçada – *Manual de Direito*… p. 72.

CHAPTER 1: THE PERMANENT ESTABLISHMENT CONCEPT IN THE 2014 OECDMC – The Foundation

Following our brief remarks on the OECDMC and the PE concept for the necessary guidance on this thesis, we will now venture into the core of our work, starting with its foundation.

The BEPS Project's Action 7[42], the MLI and other echoes from the proposed amendments to the PE concept originated from, and were based on, the PE definition outlined in article 5 2014 OECDMC[43]. Considering that our work is primarily focused on the PE definition, its amendments, impacts and evolution thus far, we must first introduce the reality at stake at the beginning of this process, hence allowing a better understanding of the steps taken.

In July 2014, following several years of work from the OECD's Committee on Fiscal Affairs and its Working Parties, the OECD released its updated Model Convention on Income and on Capital. The update generally followed the work developed by the OECD since 2010 and that was periodically made public under the discussion drafts released before the update, even though not all proposed amendments were embraced[44].

However, the issues identified in the BEPS Project[45] were not addressed in this update, with the OECD opting to only address them later on following the release of the BEPS 2015 Final Reports[46], such as the PE proposed amendments. Nevertheless, there were still some elements of the PE concept that were adjusted under the 2014 OECDMC update, *e.g.* broadening the scope of article 5 (1)[47].

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[42] OECD – *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 – 2015 Final Report*. OECD/G20 Base Erosion and Profit Shifting Project. OECD Publishing. Paris, 2015. pp. 9-14. Available at: http://dx.doi.org/10.1787/9789264241220-en

[43] OECD – *Model Tax Convention on Income and on Capital: Condensed Version 2014*. OECD Publishing. Paris. 2014. Available at: https://doi.org/10.1787/mtc_cond-2014-en

[44] BARRET, Edward – *The Changes Introduced by the 2014 Update to the OECD Model Tax Convention*. Bulletin for International Taxation. Volume 68, number 10 (2014) p. 529

[45] OECD – *Action Plan on Base Erosion and Profit Shifting*. OECD Publishing. Paris. 2013. Available at: https://doi.org/10.1787/9789264202719-en

[46] BARRET, Edward – *The Changes Introduced*… p. 529; STORCK, Alfred; ZEILER, Alexander – *Beyond the OECD Update 2014: Changes to the Concepts of Permanent Establishments in the Light of the BEPS Discussion* In LANG, Michael [et. al.] eds – *The OECD-Model-Convention and its Update 2014*. Books IBFD. 2015. p. 1.

[47] STORCK, Alfred; ZEILER, Alexander – *Beyond the OECD*… p. 1.

Considering the scope of this thesis, the 2014 OECDMC update will not be dealt with herein in further detail. Still, in the following sections, we will describe with some detail the PE concept as it read in the 2014 OECDMC because as we have established, it is the basis for the BEPS Project and its consequences, which are the core of our work. We will cover the guidance provided by the 2014 OECDMC on how a PE might be deemed to exist in a given scenario.

As it has been since its inception, the PE concept is defined in article 5 OECDMC, with its wording almost unchanged until 2017[48]. Still, we will evoke the wording of article 5 to provide further clarity in the coming explanation of this provision.

Also, the PE is a complex concept and it embodies two major categories, physical PE and DAPE, based on the nature of the cross-border venture and the relation with the PE[49]. Throughout this thesis, we will be referring to both categories as applicable in the context of the PE concept.

1.1. Article 5 (1) 2014 OECDMC

Article 5 (1) 2014 OECDMC defines what is to be understood as PE, setting the tone for the physical PE throughout this article:

> *"1. For the purposes 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."*[50]

From the above definition, we can identify the key elements of this provision, and therefore of the physical PE. However, these key elements do not allow the application of the PE concept to concrete situations, they first require further detail, so that they may be correctly interpreted and applied, for instance, if a cross-border venture qualifies as a PE or not.

The 2014 OECDMC Commentary on article 5 (1) provides the much-needed detail on what is to be understood by each of the elements of this definition, through

[48] *Ibid*.
[49] Regarding article 5 (3) OECDMC, a third category may also be presented, the project PE. The 2014 OECDMC also has a PE concept specific for the rendering of services, referred to as services PE, as well as other less material subcategories, however, these are outside this thesis's scope.
[50] OECD – *Model Tax Convention*… 2014.

examples and tests on what may constitute a physical PE, thus allowing its consolidation with depth and its recognition in practice.

The 2014 OECDMC Commentary offers various criteria that ease the application of the PE concept to real cases. We will be examining the key elements of the physical PE based on the criteria offered by the 2014 OECDMC Commentary. Broadly, a physical PE is deemed to exist where there is a place of business, which must be fixed at a distinct location and have some degree of permanence, through which the business of the enterprise is carried on[51].

In the following subsections, we will explain the four tests that need to be met by the business activities performed in a country by a person for a physical PE to be deemed to exist.

1.1.1. The place of business test – *situs* test

This test refers to the physical means through which a person develops its activity in a country. To meet this test, any physical location made available to the person may be sufficient to meet the test, such as premises, facilities, installations, machinery, or simply a certain amount of space at the disposal of the person[52].

For this purpose, it is irrelevant the legal right the person has over the space it uses or even if it has one, the person may be using said space illegally, and that will not prevent it from qualifying as its place of business[53]. A person's place of business may even be located in the premises of another person, contingent on it being at the disposal of and in some control of the former[54].

Additionally, a place of business may also be understood as any tangible asset, so long as they are used to carry out the activity and are fixed, even if they are movable assets, such as a restaurant in a permanently anchored riverboat or a

[51] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 2; XAVIER, Alberto – *Direito Tributário Internacional*… p. 337; PIRES, Rita Calçada – *Manual de Direito*… p. 74.
[52] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 4.
[53] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 4 and 4.1; PIRES, Rita Calçada – *Manual de Direito*… pp. 75-76.
[54] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 4; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on Double Taxation Conventions*. 4.ª ed. Updated. The Hague: Wolters Kluwer Law & Business, 2015. Volume I. pp. 352-355.

workbench in a caravan[55]. However, being fixed does not mean that it must be effectively and permanently fixed/connected to the soil in the relevant country, fixed is intended in a sense of permanency and stability within the location. By contrast, intangible assets cannot qualify as a place of business for this purpose[56].

The presence of personnel may also be irrelevant, as an internet server may constitute a place of business, similarly to automatic equipment[57].

It is important, however, to distinguish between the use of a place and the mere presence in it[58]. The essential criterion for assessing the use of a certain space is if such space is at the disposal of the person, *i.e.* if the person has freedom in the way to use such space, based on factual evidence, alluding to a notion of control[59].

1.1.2. The location test – *locus* test

The *locus* test derives from the expression "fixed" in article 5 (1) 2014 OECDMC and it refers to a specific link between the place of business and a concrete location in the relevant country, a nexus. In this sense, the place of business must be truly located in the other Contracting State, according to international standards, which may be of importance regarding assets placed in orbit[60].

However, as seen[61], this element does not require the place of business to be effectively fixed to the soil in the relevant country, it suffices that it remains at a concrete location for a certain period of time, a lasting place[62]. This test should be analysed together with the *situs* test since the connection between both is a vital point[63].

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[55] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel* on… p. 337; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 302.
[56] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 337; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 42.3.
[57] KAROLYI, Balazs – *The Challenges of Permanent Establishment Concept and the Response of BEPS Actions*. 2017. Tilburg. Master thesis. p. 23; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 10 and 42.2.
[58] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 4.2-4.5.
[59] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 354; PIRES, Rita Calçada – *Manual de Direito*… p. 76; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 48.
[60] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 5.5.
[61] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 343-344.
[62] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 5; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*. p. 302; PIRES, Rita Calçada – *Manual de Direito*… p. 76.
[63] DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*. p. 302.

Special attention needs to be given to situations where the nature of the business activities carried on by a person is not compatible with a traditional view of the "fixed" element. Even where the activity, by nature, has some level of mobility, a single place of business may still exist, and the location test can still be met if that business is commercial and geographical coherent as a whole[64].

It should be stressed that the "commercial and geographical coherent" theory's elements are cumulative and must be analysed together as one, *i.e.* if a given activity is only geographically coherent but not commercially, or vice-versa, the *locus* test will not be met and the PE threshold will not be reached[65]. Also, the scope for this analysis is restricted to situations where it is not possible to identify a single place of business since the activity is exercised at different geographical points[66].

1.1.3. The duration test – *tempus* test

Inherent to the PE concept itself, the relevant person must carry on its activity in the other Contracting State with a certain degree of permanency, meaning that the activity must have temporal stability[67]. This test reveals itself as the other half of the expression "fixed" in article 5 (1) 2014 OECDMC.

By contrast, this test will not be met, and a PE will not be deemed to exist, where the activity exercised is of a purely temporary nature, such as preparatory works, although certain aspects must be carefully assessed in this regard.

We highlight that, despite the discussions held, article 5 (1) 2014 OECDMC Commentary does not refer to any specific time limit upon which a person carrying on its activity meets this test; however, countries' practice tends to point to a 6-month threshold[68].

On the temporary nature of activities, should the activity exercised by the person be of short-time nature and its whole business activity is complete in that

[64] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 5.1; PIRES, Rita Calçada – *Manual de Direito*… pp. 76-77.
[65] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 345; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 5.1-5.4.
[66] PIRES, Rita Calçada – *Manual de Direito*… p. 76.
[67] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 346; PIRES, Rita Calçada – *Manual de Direito*… p. 77.
[68] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 6; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 346-347; PIRES, Rita Calçada – *Manual de Direito*… pp. 77-78.

short period (*e.g.,* a sports event or other one-off events), then the duration test may still be fulfilled[69].

Furthermore, it is also understood that when the activity is exercised for a short period of time in the other Contracting State but has a recurring character, that is, in the following year it develops the same activity again, or every two years, (*e.g.,* festivals or fairs), then the *tempus* test may still be fulfilled and a physical PE may be deemed to exist[70]. In both situations, the periods should be aggregated to confirm whether the duration test is met, which will always require a case-by-case analysis of the business activity carried on[71].

However, the analysis over activities of an itinerant nature and similar, such as the case of itinerant circuses, should not accompany the view mentioned above, given the intrinsic differences in the nature of the activities, reason why such activities might not comply with this test[72].

Akin to the analysis required on the abovementioned activities, the 2014 OECDMC Commentary on article 5 (1) provides that a factual and subjective analysis on this test must be made by reference to two types of activities (i) those that end prematurely and (ii) those that are extended over initial estimations.

This is a supplementary analysis to qualify a situation as a physical PE. Regarding the first type of activities, a place of business may still be deemed to be a PE from inception if, due to special circumstances (*e.g.,* investment failure), it is prematurely liquidated[73].

On the second type of activities, it is necessary to attend to the initial design of the activity and its envisaged timeframe, where the initial design was of short duration and the *tempus* test would not be satisfied, but with the extension of the

[69] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 6; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 352-353.
[70] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 6, 7; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 350-351.
[71] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 352-353, 357-360.
[72] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 350-351.
[73] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 348; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 6.3.

activity, the threshold is exceeded and a physical PE may be deemed to exist retrospectively[74].

Finally, we highlight that temporary interregnums (*e.g.,* holidays, inactivity due to lack of demand or seasonal activities) do not jeopardize the recognition of the business activity carried on as a physical PE[75]. This reference is fundamentally meant to fight abuse; thus, the relevant person may not manipulate the activity exercised and the interregnum in such a way as to avoid its recognition as a PE.

This reference also applies to cases of alternate use of a place, with interruption of control over it, or where the fixation is removed sporadically[76]. The same anti-abuse logic applies to situations where a place is periodically used by similar businesses carried on by the same person or a group of related persons, aiming at securing a qualification as a temporary activity and evading the recognition as a physical PE. The periodic rotation should be disregarded and interpreted as a single use[77].

1.1.4. The business activity test – "through" test

The final test that must be met for a particular activity to be recognized as a physical PE is a multi-pronged dynamic test[78], it has several nuances and all should be taken into consideration.

1.1.4.1. Business activity

As a starting point, it is paramount that the activity carried on by the person must be an actual business activity, which resonates from the expression "business of an enterprise" of the definition in article 5 (1) 2014 OECDMC. This interpretative

[74] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 6.3; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*. p. 302.
[75] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 6.1, 7, 11; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 349.
[76] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 350.
[77] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 6.2.
[78] XAVIER, Alberto – *Direito Tributário Internacional*… p. 311.

guideline serves the purpose of excluding from the scope of a physical PE both passive and occasional/low-scale investments in another Contracting State[7980].

The qualification as a business activity is not hinged on its ability to turn a profit, or even on being a core business of the person, in fact, this test may be satisfied when a business activity is loss-making, as it is not necessary to have a productive character[81]. Also, it is understood that for the business activity to qualify as a physical PE of the relevant person, the business activity carried on must be that person's own business, and not carried on behalf of another person (in which case, the potential physical PE may be recognized in relation to the latest and not the former)[82].

The key point here is that the person is actively carrying on its own business activity through a place of business in the other country, which may or may not be productive and profitable, it might even be an omission[83].

It is also important to consider preparatory works when discussing business activities. As we have stated, when such works are of pure temporary nature, the *tempus* test will not be satisfied, also, as we will mention further along, these activities might even be excluded from the scope of PE[84]. However, when preparatory works cease to be temporary and merely preparatory, a PE might be deemed to exist from its inception, unless those preparatory activities are different in nature to the activity to be carried out, which should not be considered for purposes of fulfilment of these tests[85].

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[79] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 2, 3, 7; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 338-342.

[80] However, passive activities, such a leasing (of tangible or intangible assets), may fulfil this test if certain complementary works are included and the lease is made through a FPOB, both a risk and control test are advanced for these situations' analysis. OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 8.

[81] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 2-3; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 356.

[82] KAROLYI, Balazs – *The Challenges of*… p. 26; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 7; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 356.

[83] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 356.

[84] If they have a preparatory or auxiliary character under article 5 (4) 2014 OECDMC.

[85] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 11; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 348-349.

1.1.4.2. "Through which"

Having covered the nuances of this test on the business activity aspects, we will advance to another of its prongs, the vital element related to how the business activity is carried out, *i.e.* the "through which" element. This element focuses on the integration between the activity carried out and the place of business, demanding that the activity is wholly or partially carried out through it[86]. For this purpose, certain features are relevant for analysis, including if such place of business is under the control and at the disposal of the person[87].

In this sense, the place of business needs to be in control of the person, the person needs to have some power over the place of business for it to qualify[88]. However, such control over the place does not need to be exclusive, different degrees of control may still be sufficient to comply with this test, the control may even be shared, as it will depend on the type of business activity the person carries on[89]. Again, a casuistic analysis should be undertaken in this respect, while discretion in the use of the place of business is a significant sign of control.

Together with the control of the place of business, it should be stressed that the business activity needs to be functionally integrated into that place of business, the business activity needs to be wholly or partially carried out through that place of business[90]. As we have noted, the activity may be loss-making, or even an omission, but it must be carried out through that place of business, otherwise, the physical PE threshold will not be reached. This element's analysis requires an integrated view of the remaining tests since they are all well interconnected.

On this topic, we highlight that a discussion has been held at the OECD about the replacement of the wording "in" by "through" in this context. This has not been consensual between countries and the OECD has understood both expressions as

[86] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 7; PIRES, Rita Calçada – *Manual de Direito*… pp. 78-79.
[87] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 4.1-4.2.
[88] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 353.
[89] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 354-356.
[90] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 356; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 2, 10.

synonyms, disregarding the introduction of a requirement for an instrumental character of the place of business[91].

A final note to the means a business activity is carried out by the person, as we have seen in the case of servers, a business activity may be carried out with or without personnel, depending on its nature[92]. Further to this example, a physical PE may also be deemed to exist where a person carries on its activity mainly through automatic equipment, such as vending machines or airline check-in terminals, so long as that activity does not qualify as a mere lease, passive activity, but it is truly operated and maintained by the person[93].

Should a person's business activity fulfil all the tests herein depicted, a physical PE might be deemed to exist. As we will explain in the coming sections, some exceptions may apply to a business activity, thus excluding it from being recognized as a physical PE.

This section establishes the core of the physical PE concept, from where physical presence emanates as the decisive element for allocation of taxing rights over its business profits to the Source Country. Having set this base, the following three sections will dive into the ramifications of the physical PE, establishing examples, special qualifications and limitations.

1.2. Article 5 (2) 2014 OECDMC

Continuing with the development of the physical PE concept, article 5 (2) 2014 OECDMC provides a non-exhaustive list of examples that may constitute a physical PE, shedding some light on the concept of physical PE presented in article 5 (1) 2014 OECDMC[94]:

"*2. The term "permanent establishment" includes especially:*

a) a place of management;

[91] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 356-357; KAROLYI, Balazs – *The Challenges of*… p. 26.
[92] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 10.
[93] *Ibid*.
[94] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 12; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 362.

b) a branch;

c) an office;

d) a factory;

e) a workshop, and

f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources."[95]

As referred, this list is not exhaustive, nor is it its purpose, as the ingenuity and creativity of the global economic operators are very rich. Therefore, a watertight list of physical PEs would result in a potentially high risk of tax planning and abuse to circumvent the list and avoid the PE recognition.

1.2.1. Qualification

One of the features that emerge from article 5 (2) 2014 OECDMC is whether there is an automatic qualification of any of those situations as a physical PE simply because they are included in the list, meaning that there would be no need to screen these situations under the abovementioned tests. Or, if it still is necessary that those situations fulfil the article 5 (1) 2014 OECDMC's tests[96].

This feature has been widely overcome by scholars and country practice, with the 2014 OECDMC Commentary on article 5 (2) also bringing clarity on this topic. In fact, a consensus has been reached in asserting that the examples provided in article 5 (2) 2014 OECDMC are not physical PEs *per se*, this article is not a deeming provision, the physical PEs tests still need to be fulfilled[97].

Article 5 (2) 2014 OECDMC is a mere exemplification of the physical PE definition, it does not extend its scope, and the examples may even overlap. Beyond the exemplification, the list also serves as a clarification of some of the physical PE's elements[98]. Hence, article 5 (1) and (2) 2014 OECDMC should be jointly and

[95] OECD – *Model Tax Convention*… 2014.
[96] XAVIER, Alberto – *Direito Tributário Internacional*… p. 339; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 360-362.
[97] XAVIER, Alberto – *Direito Tributário Internacional*… p. 339; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 360-362; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 12; PIRES, Rita Calçada – *Manual de Direito*… p. 79.
[98] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 361-362.

complementarily analysed, for example, an office might not reach the PE threshold if the *tempus* test is not met.

1.2.2. Exploration and exploitation activities

Another concern that derives from this illustration results from article 5 (2) (f) 2014 OECDMC when referring to any other place of extraction of natural resources. On the one hand, a broad meaning should be given to this example, so that it includes, for example, any place of extraction of hydrocarbons (on and offshore)[99].

On the other hand, countries have not reached a consensus on whether this example also includes the exploration activities of such natural resources, therefore they have the discretion to include specific clauses to determine whether or not a person that carries on exploration activities is deemed to have a physical PE, or if it must overcome a specific time limit for this purpose[100].

The merits of the list on article 5 (2) 2014 OECDMC are basically of further clarity and detail concerning the definition of the physical PE, keeping an intrinsic relation between both articles, with article 5 (1) 2014 OECDMC always prevailing over article 5 (2) 2014 OECDMC, meaning that a listed example might not constitute a physical PE or that a PE might be deemed to exist in a situation not listed.

As stated, this ramification of the physical PE concept serves the purpose of assisting the main concept, without impacting the scope, by providing concrete examples of scenarios that might constitute PEs. The same cannot be said about the following two sections.

1.3. Article 5 (3) 2014 OECDMC

Article 5 (3) 2014 OECDMC embodies the first true influence on the physical PE's scope as established by article 5 (1) 2014 OECDMC[101]:

[99] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 14.
[100] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 15; XAVIER, Alberto – *Direito Tributário Internacional*… p. 339.
[101] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 16.

"*3. A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.*"[102]

As stated, this provision is commonly known as project PE, considering its wording, nature and the way it influences the physical PE concept. However, there is no consensus on whether this article is a proper category of PE or another exemplification[103][104].

1.3.1. Nature and relation with article 5 (1) 2014 OECDMC

The project PE has a heterogeneous nature vis-à-vis article 5 (1) 2014 OECDMC, as it is simultaneously an extension and a limitation on its scope, thus giving some cause to its qualification as a third category that has particularities in comparison with the physical PE[105].

The project PE sets a limitation on the scope of the physical PE through a 12-month time limit threshold, as an exception, therefore such a PE will only be deemed to exist if this objective threshold is surpassed[106].

At the same time, it can also be argued that the project PE widens the scope of the physical PE, by adapting how the four tests abovementioned are met for a PE to be deemed to exist, as occurs with the *locus* and the "through" test[107].

Considering the type of activities included in article 5 (3) 2014 OECDMC, they are generally more movable and less fixed, they do not require the same degree of control over a place of business and the places where these activities are carried out are their own object of activity, not an instrument through which they are carried out[108].

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[102] OECD – *Model Tax Convention*… 2014.
[103] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 364; XAVIER, Alberto – *Direito Tributário Internacional*… p. 338.
[104] We will use the wording "project PE" or "project PE concept" to refer to the special qualification made on the physical PE foreseen in this provision.
[105] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 366. BARBIER, Casper – *The Permanent Establishment in a post BEPS world*. 2016. Tilburg. Master thesis. p. 39.
[106] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 364; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 16; PIRES, Rita Calçada – *Manual de Direito*… pp. 82-83; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 64.
[107] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 364-365; PIRES, Rita Calçada – *Manual de Direito*… pp. 82-83.
[108] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 364-365. OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 20.

We adhere to the understanding that the project PE is not another mere example, but a considerable extension and exception to the physical PE concept as outlined in article 5 (1) 2014 OECDMC.

This being said, the project PE is not an autonomous concept[109] nor a deeming provision[110], meaning that there is still some interconnection with the physical PE's tests, although adapted. A combined approach should be used when analysing a potential project PE. Nonetheless, there is no consensus on this matter[111].

In this sense, no project PE will be deemed to exist where the only test verified is the 12-month period, meaning that there is still is a strong physical presence nexus. Also, if a qualifying project activity only lasts for 4 months the project PE is precluded[112].

The interconnection between articles is demonstrated by the 2014 OECDMC Commentary when it states that, where a building site or construction or installation project has within it a listed example of a physical PE dedicated to it, such as an office, and the 12-month period is not reached, then no project PE exists, meaning that in this scenario the project PE eclipses the physical PE[113].

However, where such an office located in a person's building site develops plans and projects for other building sites, that office may be deemed to be a physical PE, as per article 5 (1) and (2) 2014 OECDMC, even if the 12-month period threshold is not reached by the other building sites[114]. It may even occur that two PEs exist, a physical and a project[115].

1.3.2. Scope and persons

The scope of the project PE should not be read as being limited only to its wording, which has an illustrative nature, therefore it should be given a broad

[109] In contrast: BARBIER, Casper – *The Permanent Establishment*… p. 39.
[110] In contrast: KAROLYI, Balazs – *The Challenges of*… pp. 28-29.
[111] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 364-365; BARBIER, Casper – *The Permanent Establishment*… p. 39; KAROLYI, Balazs – *The Challenges of*… pp. 28-29; KOSTIC, Svetislav V. – *Chapter 3: New*… p. 3.
[112] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 365; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 16; KAROLYI, Balazs – *The Challenges of*… p. 28.
[113] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 16.
[114] *Ibid*; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 366.
[115] *Ibid*.

meaning, to include other activities of the same nature as those mentioned, such as the construction/installation/renovation of roads, power plants, dams, on-site planning and supervision, dredging and other similar activities, but not maintenance or repairs[116]. It should also encompass the installation of new equipment, such as machinery, be it indoor or outdoor and some secondary activities[117].

There are certain nuances on who will be deemed to have a project PE and what will it be, as it is based on location and streams of income perceived rather than on the relevant person[118]. On this note, it is irrelevant whether the person is the contractor and executes all the work or if it outsources all the work to subcontractors, in fact, they may both be deemed to have a PE each, being relevant for the contractor if some level of control is still kept[119].

Additionally, in the case of subcontractors, the time spent by these will be aggregated to the time of the general contractor that outsourced the activity for the verification of the 12-month period threshold[120]. This is, in its essence, an anti-abuse interpretation of the time requirement, preventing general contractors from subcontracting all, or part, of the elements of their activities so that they do not reach the 12-month period.

The same anti-abuse purpose is present in the application of the 12-month period to fiscally transparent partnerships, which is carried out at the level of the partnership itself, as an enterprise, considering the time spent by the partners and the employees of the partnership on the site[121]. Should the threshold be exceeded, the activities carried on by the partnership will be considered to be a PE, which will in its turn be extended to the partners and their share of the business profits, following the nature of the person itself[122].

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[116] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 17; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 367-368; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 73-74, 76-77.
[117] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 17; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 367-368.
[118] MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 61-62, 64-65.
[119] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 19; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 366-368.
[120] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 19.
[121] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 19.1; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 366.
[122] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 19.1.

1.3.3. 12-month test

Each site or project must be analysed independently of others and must take into consideration the activity carried on in it when applying this test. As such, when applying the 12-month test to a specific site, no relevance should be given to the time spent by a contractor on other sites which are utterly unconnected with it[123].

Notwithstanding the above, where there is a connecting factor between sites, no separate analysis should be conducted, for instance when a building site is made up of several contracts, provided that, when together, those create a commercial and geographical coherent whole, similarly to the *locus* test of the physical PE[124]. A building site will continue to be considered as a single unit even if the contracts arise from multiple persons, subject to the commercial and geographical coherence test, or if by its very nature it has to be relocated[125].

Regrettably, the 2014 OECDMC Commentary on article 5 (3) is poor in details and guidance on the dichotomy between the single unit approach and the separate approach to a building site, even though they are both endorsed therein.

Still, it is possible to interpret both approaches based on the tests provided, the (i) commercial and geographical coherence test and the (ii) unconnected test. Under such an analysis one should consider the persons involved, the geographical places where the relevant activities are carried out, the diverseness (or lack of it) of the objects created, and the types of activities carried out[126].

A higher level of similarity and integration of these elements will strengthen a single unit approach, *i.e.* if the sites form a geographically coherent whole, or if the activities performed are connected and form part of the person's business[127]. Otherwise, the separate approach should be favoured. This further demonstrates that this article is not a mere clarification of the physical PE.

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[123] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 18, 20; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 369.
[124] *Ibid*.
[125] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 18; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 369.
[126] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 369-372; PIRES, Rita Calçada – *Manual de Direito*… p. 84.
[127] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 369-372; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 20; PIRES, Rita Calçada – *Manual de Direito*… p. 84.

Special mention goes to the reference made on the 2014 OECDMC Commentary on abuse concerning the avoidance of the 12-month test by splitting-up contracts between persons of the same group. Through this practice, no person would meet the 12-month threshold and therefore no project PE would be deemed to exist, already revealing a substance-over-form approach by the OECD[128].

1.3.4. Preparatory works and interruptions

As we have seen, it will be necessary that a building site lasts for more than 12 months for a project PE to be deemed to exist. Such rule stems from the *tempus* test of the physical PE but was stretched and tailored for this purpose, *e.g.* the designed duration is irrelevant[129].

It is relevant to consider how the 12-month period is computed, namely when it begins and whether interruptions have any effect over it.

The computation of the 12-month period begins on the day the person begins the qualifying business activities on the location connected with the building site[130]. The preparatory works carried out in the country of the building site will be included in this computation, provided such works are connected with the relevant site and that they have some economic substance[131].

On the other end, the computation of the 12-month period will cease on the date the activities are completed. The termination of the activities should not be reduced to the mere conclusion of the core building, construction and/or installation activities. Complementary works, such as wrapping-up activities during the post-building, construction and/or installation phase are also included, like testing and the removal of equipment[132]. However, maintenance works, warranty claims and similar activities must not be included in this computation, similarly, post-works

[128] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 18; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 369.
[129] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 372.
[130] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 19; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 372.
[131] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 19; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 372-373; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 78.
[132] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 373.

activities outside the country of the site and off-site activities must also be discarded[133].

Following the relevant moments for the beginning and the end of the project PE's 12-month period, all that is remaining is the time in-between, namely the relevance of interruptions. Regardless of the cause, temporary interruptions, such as weather-related or shortage of raw material, should still be included in the computation of the 12-month period, as they constitute an inherent element of the economic activity and are a part of the risk of a business[134].

Otherwise, the hourglass on the 12-month period should be flipped and reset when the interruption is significant, in time or in its cause, such as the dismantlement of the site due to bankruptcy of the client[135].

As we have put in evidence, article 5 (3) 2014 OECDMC exerts a considerable effect in the scope of the physical PE, contrary to article 5 (2) 2014 OECDMC, its mixed nature of limitation and extension paves the way for it to be considered an almost third category. However, the project PE is not entirely autonomous due to its synergies and interrelations with the physical PE resulting from article 5 (1) and (2) 2014 OECDMC.

The project PE is an extended ramification of the physical PE, with different shades as to its tests and requirements, and a slightly different scope, but an identical basis. Bearing this in mind, a project PE may be deemed to exist where the physical PE threshold would not be reached by reference to the same person's qualifying business activity, being the contrary also possible, which is a strong testimony to the relationship between both concepts.

While the project PE concept seeks to cast a wider, but limited, net over business profits generated in the Source Country, as opposed to the one cast by the physical PE, the purpose of the following ramification of physical PE is the exact opposite.

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[133] *Ibid*.
[134] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 19; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 373; KAROLYI, Balazs – *The Challenges of*… p. 30.
[135] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 373.

1.4. Article 5 (4) 2014 OECDMC

The last ramification of the physical PE concept[136] aims at diminishing the capabilities of the PE concept to allocate taxing rights to the Source Country, rising the threshold, by expressly excluding certain types of business activities from constituting a PE, even if carried on through a FPOB[137]:

"*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."[138]

Article 5 (4) 2014 OECDMC puts forth a list of business activities that will not be deemed to give rise to a PE, basically a negative catalogue of PEs, or in other words, a register of activities that may allow the person carrying them on to not be subject

[136] Regardless, as we will demonstrate, article 5 (4) 2014 OECDMC's influence is also exerted over the DAPE.
[137] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 21 and 23; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 375.
[138] OECD – *Model Tax Convention*… 2014.

to taxation in the Source Country[139]. Article 5 (4) 2014 OECDMC is often regarded as the specific activity exemptions provision.

This negative catalogue is mostly valuable from the PE concept's practical application perspective, as a sealed inventory of the character/nature of business activities and not of specific activities, which provides a wide range[140].

The business activities listed therein derive mainly from practical difficulties in the attribution of profit to such activities[141] and when profits are allocated, the resulting taxation is not meaningful vis-à-vis the difficulties inherent to the analysis of such cases[142]. Another reason that led to the development of this negative catalogue relates to the purpose of DTTs, to foster cross-border commerce, which often requires preparatory or auxiliary activities to be executed[143].

It should also be noted that with such a list of preparatory or auxiliary activities the legal certainty increases for persons in cross-border investments, as there is some expectation as to what will not be considered a PE in the Source Country.

1.4.1. Nature

Considering the listed preparatory or auxiliary activities in this provision, one can easily state that such business activities would likely be deemed to constitute a physical PE, however, as they are inserted in this negative list, such status is barred[144]. In such cases, article 5 (4) 2014 OECDMC operates as a direct carve-out provision to article 5 (1) 2014 OECDMC[145]. On the contrary, when the listed business activities would fail to qualify as a PE under article 5 (1) 2014 OECDMC, the nature

[139] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 21.
[140] WETTERSTEN, Maria – *How can the proposed changes to the OECD tax model convention in action 1 and action 7 counter the issue of an artificial avoidance of a PE status?*. 2016. Lund. Master thesis. p. 9.
[141] Which is dealt with in article 7 2014 OECDMC and outside this thesis's scope.
[142] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 375; XAVIER, Alberto – *Direito Tributário Internacional*… p. 340; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 23.
[143] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 375; SOUSA, Ricardo Quelhas – *A Acção 7 do BEPS: Questões Pendentes em Matéria de Estabelecimentos*. 2016. Porto. Master thesis. pp. 16-17.
[144] XAVIER, Alberto – *Direito Tributário Internacional*… p. 339; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 21.
[145] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 375.

of this article shifts to a mere illustrative purpose, similar to the positive list of article 5 (2) 2014 OECDMC[146].

1.4.2. Structure

The structure of article 5 (4) 2014 OECDMC, can be divided into two separate compartments, one compartment includes paragraphs (a) to (d) and the other is comprised of paragraphs (e) and (f). This division results essentially from the wording and application of each paragraph to a specific business activity.

This feature has been widely discussed by the OECD and scholars and has had divergent country practices throughout the globe, without ever reaching a consensus between all parties[147].

This feature is one of the topics covered in Action 7, in any case, and for this Chapter's purpose, it matters to introduce the discussion on this topic and to establish our take on it, paving the way to the next Chapter.

In this sense, the dichotomy between both compartments rests on the qualification of the paragraphs vis-à-vis the preparatory or auxiliary character, *i.e.* if the activities listed in paragraphs (a) to (d) are automatically deemed to have such a character[148] or if they require an analysis to assess such a character, like paragraphs (e) and (f)[149].

The 2014 OECDMC and its Commentary on article 5 (4) are also considered in this dichotomy, as it seems that they take a stance on this discussion, even though its interpretation is also diverse[150].

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[146] *Ibid*.

[147] SOUSA, Ricardo Quelhas – *A Acção 7*… pp. 20-28.

[148] XAVIER, Alberto – *Direito Tributário Internacional*… pp. 313-314, 339-340; KAROLYI, Balazs – *The Challenges of*… p. 27; GILLESPIE, John – *The Base Erosion and Profit-Shifting Project, Action 7: A Critical Analysis of the Preparatory/Auxiliary Extension and the New Anti-Fragmentation Rule in the 2017 OECD Model Tax Convention*. 2018. Uppsala. Master thesis. p. 17; CUNNINGHAM, Kevin – *The Post-BEPS World of Permanent Establishment*. Tax Notes International. Volume 82, number 5 (2016) p. 507; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 6-7, 18.

[149] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 376, 380; STORCK, Alfred; ZEILER, Alexander – *Beyond the OECD*… pp. 13-15; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 108-113

[150] On this point, the diverse interpretation arises from the expression "other" in article 5 (4) (e) 2014 OECDMC and from the content of paragraph 21 of the OECDMC Commentary to this provision stating that "*[the] common feature of these activities is that they are, in general, preparatory or auxiliary activities*".

At the OECD level, the consensus on this matter has often been that the first compartment constitutes a deeming exception from PE status for the activities listed, as per the thorough analysis made by Jacques Sasseville, whose conclusions we follow[151].

Our take on this conundrum is that the first compartment of paragraphs is, in fact, a deeming exception to article 5 (1) 2014 OECDMC, without the need for any further analysis on the true character of the activities, as they are traditionally by nature preparatory or auxiliary and fairly distanced from traditional income-generating core activities, and also taking into consideration the OECD's stance on the matter (as per the historical analysis mentioned), some country's practice[152] and the view portrayed by relevant scholars and practitioners (some of which we have referred to).

Hence, throughout this thesis, and specifically, in this section, we will be taking the abovementioned view on this matter.

Notwithstanding the above, we take note of the legitimacy of the discussion and the lack of consensus on this matter, which gave rise to divergent practices by countries and tax administrations. The consequences and aftereffects of this view will be dealt with in greater detail in the following Chapter.

1.4.3. Scope

Following the basis of our interpretation and application of article 5 (4) 2014 OECDMC, we will dive into the scope of its paragraphs and how those should be analysed.

The paragraphs that comprise article 5 (4) 2014 OECDMC's first compartment describe similar situations, with minor differences between them, apparently without much leeway on the extrapolation of its meaning and intended targets[153]. In fact, the only latitude an interpreter has under the 2014 OECDMC Commentary is by

[151] We refer to the analysis made by Jacques Sasseville on MAISTO, Guglielmo [et. al.] eds. – *New Trends in the Definition of Permanent Establishment*. Volume 17 of EC and International Tax Law Series. Books IBFD. 2019. pp. 3-19.
[152] GARBARINO, Carlo – *Permanent Establishments and BEPS Action 7: Perspectives in Evolution*. Intertax. Volume 47, issue 4 (2019) pp. 368-369; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 105-107.
[153] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 22.

reference to paragraph (d), which is to be understood as also including the "purchase/collecting of information" by a newspaper bureau for its parent company[154].

However, the activities comprised therein should be interpreted broadly, so that activities that are typically connected are included, so long as those activities are still similar in nature to the ones expressly identified, like controlling the quality of goods purchased or packaging of goods for delivery[155].

Some of the activities, locations or objects included in the first compartment's paragraphs might not qualify for purposes of article 5 (1) 2014 OECDMC, as they would fail its tests. Still, this list brings further clarity and certainty that a PE will not arise from the maintenance of stock, the use of facilities or the displaying of goods[156].

By contrast, while the paragraphs in the first compartment refer to specific activities, those included in the second compartment have a broader sense. Paragraph (e) is a general exception to the PE, a sort of preparatory or auxiliary character guarantee, where others do not apply, this might and provides an additional test for physical PE[157]. In its turn, paragraph (f) is fundamentally an anti-abuse provision against single persons fragmenting their activity, which aggregates such activities[158].

Considering their purpose, the paragraphs included in the second compartment have the flexibility needed for the interpretation of what is preparatory or auxiliary character and for the analysis of the relevant activities, although restrained by the circumstances of each one[159].

1.4.4. Preparatory or auxiliary character

Up until now, we have explained the nature, structure and scope of article 5 (4) 2014 OECDMC, leading up to the application of this exception. For this exception to apply, avoiding the PE status, it is first necessary that the relevant activity fulfils the

[154] *Ibid*.
[155] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 379.
[156] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 377-380.
[157] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 23; KAROLYI, Balazs – *The Challenges of*… p. 27.
[158] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 27-27.1.
[159] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 23-24, 27.

preparatory or auxiliary character test[160]. This test is the core element of this provision and vital in its application, specifically for paragraphs (e) and (f).

Our understanding is that article 5 (4) (a) to (d) 2014 OECDMC are deeming exceptions to the PE concept, denoting that the activities listed, by their very nature, are of preparatory or auxiliary character. Such understanding conveys two conclusions (i) this test is automatically fulfilled for those activities and (ii) those activities are illustrative examples of activities with a preparatory or auxiliary character[161].

The preparatory or auxiliary character test is multi-layered and complex, and there is no strict or clear guidance on what the preparatory or auxiliary character of an activity is, other than it does not qualify as the main activity. This test can be ascertained based on the criteria that we will explain below, which should be met to prevent the PE status, and on a case-by-case basis[162].

1.4.4.1. Impact on the person's activity

As a prior note, we first need to establish the point of reference for the analysis of this criterion, which is to be used throughout the analysis of the preparatory or auxiliary activity test.

The point of reference is instrumental in this analysis as the same activity might qualify as preparatory or auxiliary in a macro context and as the main activity in a micro context[163].

In this sense, the autonomous application of a micro or a macro point of reference to this criterion is not suitable, as they could give rise to distortions, therefore we favour a combined point of reference, although firstly a micro context is more adequate, *i.e.* how the relevant activity fits in the context of the person

[160] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 21, 23, 27.
[161] XAVIER, Alberto – *Direito Tributário Internacional*… p. 313; GILLESPIE, John – *The Base Erosion*… p. 17.
[162] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 24; ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the various definitions of Permanent Establishment can limit the taxation ability of resource-rich source countries*. CCSI Briefing Note, Columbia Center on Sustainable Investment. 2018. p. 9.
[163] SOUSA, Ricardo Quelhas – *A Acção 7*… pp. 18-19; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 380-382.

carrying on such activity and not initially against a macro view of the economic chain[164].

One of the elements that should be taken into consideration when assessing this test, and the decisive criterion, is the impact that the relevant activity has on the person's overall activity[165]. Naturally, even a preparatory or auxiliary activity may contribute to the person's overall productivity, however, such activity's impact is also generally quite remote from the actual realization of profits, such as mere advertising[166].

On the contrary, should such activity constitute an essential and significant element of the person's activity as a whole, then the activity should be regarded as not having a preparatory or auxiliary character[167].

The elements provided for this criterion by the 2014 OECDMC Commentary, "essential" and "significant", are not further developed or defined, but merely referred to. Still, we are able to connect such elements to the nature and relevance of the activity carried out[168].

We highlight that the management of an entity, or part thereof, is regarded as an essential part of an entity's activity and cannot be considered as a preparatory or auxiliary activity, as it may be the case where an entity has an office, in the terms of article 5 (2) 2014 OECDMC, for management, coordination and/or supervision of an international group of enterprises[169]. There is a very strong and intrinsic link between the entity and the "management office" that cannot be sustained that it is not an essential activity.

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164 REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 380-381.
165 OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 24.
166 OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 23; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 380-381; GILLESPIE, John – *The Base Erosion*… p. 19; WETTERSTEN, Maria – *How can the*… p. 9.
167 OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 24-25, 26.1; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 380-382.
168 SOUSA, Ricardo Quelhas – *A Acção 7*… p. 17.
169 OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 24; SOUSA, Ricardo Quelhas – *A Acção 7*… pp. 18-19.

1.4.4.2. Exercise and target

This criterion should be assessed side-by-side with the previous one, as a limit to the relevance of the activity carried out. Since it is also worthy of note to whom and which activity is being carried out.

If the activity exercised is indistinguishable from the core activity of the person, even if its impact on the overall activity is remote, such activity will not be regarded as a preparatory or auxiliary activity, thus possibly qualifying as a PE[170].

Also, an activity that is exercised for the person itself could be regarded as having a preparatory or auxiliary character, however, if that same activity is also exercised for other persons, related or not, then it will not have such a character and will fail this test[171].

For instance, where a specific activity is initially only exercised for the person, no PE would arise, however, when the activity expands and is exercised also for other persons, then a PE would arise and by reference to that whole specific activity, there is no split between what is preparatory or auxiliary and what is not[172].

Following the above, the relevant activity, or combined activities, needs to comply with the cumulative criteria if it is to be regarded as having a preparatory or auxiliary activity, thus preventing PE status. Furthermore, we note that the 2014 OECDMC and its Commentary does not extrapolate on a definition for "preparatory" and "auxiliary".

1.4.5. Fragmentation

As mentioned, article 5 (4) (f) 2014 OECDMC has an important role within this provision as an anti-abuse mechanism, however, this paragraph will not be applicable where a person has several places of business that are geographically and organisationally separated from each other, as there may exist legitimate reasons

[170] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 382; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 24; SOUSA, Ricardo Quelhas – *A Acção 7*… p. 18.
[171] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 382; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 26-26.1; SOUSA, Ricardo Quelhas – *A Acção 7*… p. 19; WETTERSTEN, Maria – *How can the*… p. 9.
[172] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 28, 30.

for a person to have multiple and independent places of business in a given country[173].

In this case, each place of business will be analysed separately under the relevant paragraph of article 5 (4) 2014 OECDMC[174].

At the same time, we note that no organisational separation exists when two or more places of business perform complementary functions in a Contracting State as part of a cohesive operating business. Fragmentation of a cohesive operating business, such as a supply chain, is expressly prohibited in the 2014 OECDMC Commentary[175].

A bundle of places of business should only be subject to the preparatory or auxiliary test following the effective aggregation so that the test is rendered to the activity as a whole[176].

1.4.6. Relation with article 5 (5) 2014 OECDMC

As stated, article 5 (4) 2014 OECDMC also exerts its influence on the DAPE concept of article 5 (5) 2014 OECDMC.

As such, a DAPE will be disregarded in the same way as a physical PE if the activity carried out qualifies as a preparatory or auxiliary activity[177]. The point here is the qualification of the activity and not the means through which it is carried out, a FPOB or an agent.

At this point, it is safe to say that we have brought clarity to the last of the physical PE concept's ramifications and what we stated in its introduction holds true, article 5 (4) 2014 OECDMC is a limitation to the scope of the PE concept as a whole, and not just of the physical PE, thus increasing its threshold. Although construed as a ramification of the physical PE concept, its extent goes beyond this concept.

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[173] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 27.1. REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 382.
[174] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 27.1.
[175] *Ibid*.
[176] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 382; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 27-27.1.
[177] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 28; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 391.

There are evident merits for the implementation of such limitation and some merits on how they are applied, article 5 (4) OECDMC succeeds in refraining the inherent capabilities of the PE concept to deem cross-border ventures as PEs. Still, some improvement is needed.

The analysis of the physical PE and its ramifications is essentially complete and we have made clear the relevant elements and features of the concepts and the shifts in its threshold.

In the following section, we will address the second major category of the PE concept, the DAPE concept, providing detail on its mechanics.

1.5. Article 5 (5) 2014 OECDMC

Article 5 (5) 2014 OECDMC shifts the paradigm of the PE concept that we have been working on from a FPOB to an agent carrying on activities on behalf of a person and introduces a new PE concept's category, the DAPE:

> "*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 person 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 provisions of that paragraph.*"[178]

This category was historically created to prevent the avoidance of PE status by replacing a FPOB with a representative and ensuring neutrality[179]. The DAPE concept is crucial, especially considering the growing practice of international

[178] OECD – *Model Tax Convention*… 2014.

[179] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 383-384; SHTROMBERG, Alexandra – *Managing Permanent Establishment*… pp. 52-53; CALABRESE, Mattia – *Chapter 5: Taxing the Dependent Agent Permanent Establishment in the State of Source: What Has Been Achieved through the Modifications to Article 5?* In WHEELER, Joanna ed. – *The Aftermath of BEPS*. Books IBFD. 2020. p. 5; EISENBEISS, Justus – *BEPS Action 7: Evaluation of the Agency Permanent Establishment*. Intertax. Volume 44, issue 6/7 (2016) pp. 490-491.

persons operating through representatives in other countries for conducting their activity, intensified also by the modernization of the activities[180].

The DAPE category is governed by its own set of rules and criteria, which need to be complied with for a PE to be deemed to exist, which we will analyse in detail below.

1.5.1. Nature

Although an autonomous concept, there is still some relation with the provisions previously addressed, as the exception of preparatory or auxiliary activities that also preclude a DAPE from existing. There is also an evident relation between article 5 (5) and (6) 2014 OECDMC, which will be reviewed further along.

Still, the DAPE is a deeming PE provision, as it is enough to fulfil the criteria of article 5 (5) 2014 OECDMC for a person to have PE status in the other country, under the dependent agent category, the tests of article 5 (1) 2014 OECDMC are irrelevant herein[181].

The core element herein is no longer the tight connection of a place of business to a rather specific geographical point, but the nature and type of activities exercised by the relevant person, the agent, namely if it acts for another person[182]. A DAPE exists even where there is no FPOB, thus allowing increased mobility of the activity, however, it still needs to have a link to the relevant country if a PE is to be constituted therein[183].

Before dealing with the detailed criteria of the DAPE concept, we note that this concept has a somewhat mixed nature, in the sense that on the one side it is an autonomous deeming provision, but on the other side, it is an alternative concept vis-à-vis the physical PE.

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[180] XAVIER, Alberto – *Direito Tributário Internacional*… p. 341; RIBEIRO, Cláudio de Paiva – *A tributação do*… p. 12.
[181] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 31; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 384; KAROLYI, Balazs – *The Challenges of*… p. 31.
[182] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 384; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 31.
[183] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 31; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 5.

As we have seen, the DAPE status can be reached when there is no FPOB, yet when a physical PE is deemed to exist, no analysis under article 5 (5) 2014 OECDMC is needed concerning the one in charge of it[184]. In other words, one only advances to article 5 (5) 2014 OECDMC when article 5 (1) 2014 OECDMC's threshold has not been reached.

Furthermore, the interpretation of the DAPE has as much of a positive approach as a negative one (*e.g.,* not an independent agent), as it results from the wording of the article. Some criterion needs to be achieved while others will be fulfilled through an *a contrario* analysis to constitute a DAPE. This placement resembles that of a residual test.

Also, a case-by-case analysis of the relevant situation is always necessary because, depending on the context of the agent and the person, there may or may not exist a PE. There is no objective and immediate form of qualification as a DAPE.

The DAPE threshold hinges on the assessment of the dependence of the agent vis-à-vis the foreign enterprise, however, the mere fact that a person is dependent from another one does not translate into a DAPE[185]. Although vital, there is more to this concept than just the dependence, the agent also needs to habitually exercise an authority to conclude contracts on behalf of and in the name of an enterprise in another country.

It is the joint verification of these requirements that justify the enterprise having a DAPE in the Source Country, as only in such case does the agent get the principal engaged in business activities in that country[186]. Therefore, we will explain the criteria that lead to the existence of this status.

1.5.2. Qualifying criteria

This concept relies on a specific set of criteria, based on its wording, to gauge when the DAPE threshold is surpassed: (i) a person, (ii) acting on behalf of an

[184] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 35.
[185] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 32; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 383; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável no Contexto do BEPS: O Caso Específico dos Contratos de Comissão*. 2015. Lisbon. Master thesis. pp. 17-18.
[186] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 32.

enterprise, that (iii) exercises the authority to conclude contracts, (iv) in the name of the enterprise, (v) habitually, (vi) without having an independent status. As such, these criteria should always be viewed against the dependence of the agent. For explaining purposes, we will follow the criteria as listed above.

1.5.2.1. Person

First and foremost, we need to understand what should be understood by "person". The expression "person" is properly defined in article 3 2014 OECDMC, as being an aggregate expression for "*individuals, companies and any other body of persons*", while the expression "company" refers to any corporate body[187].

Considering the extension of the expression, it is clear that an agent is not required to be an individual, even though it is the most common situation[188]. In fact, an agent can be an individual, a company, a partnership or any other similar person that is in a qualifying relationship with a foreign person[189].

Therefore, what should be regarded is not the type of person that acts as the agent, but their effective relation[190].

Two concluding notes on this criterion, one on the irrelevance of whether the agent is resident or not in the Source Country[191], and the other on the need for the agent to be distinct from the foreign enterprise, given that the agent will be acting on behalf of an enterprise. This second point will be addressed in more detail in the next subsection[192].

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[187] OECD – *Model Tax Convention*… 2014.
[188] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 385; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 32.
[189] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 385-386; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 32; PROXENOS, Jolani – *An analysis of the creation of a fixed place and agency Permanent Establishment and how BEPS Action 7 will change this*. 2017. Pretoria. Master thesis. p. 26; KAROLYI, Balazs – *The Challenges of*… p. 31.
[190] GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 17.
[191] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 32; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 17.
[192] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 386.

1.5.2.2. Acting on behalf of an enterprise

For a person to be deemed as a DAPE it is necessary that it effectively carries on an activity on behalf of a foreign enterprise, the principal. This presupposes a distinction between the two elements, "activity" and "on behalf of".

By reference to the first element, for its fulfilment, the activity carried out in the Source Country by the agent must be aligned with the core activities of the principal, meaning that the agent's activities need to be an extension from the principal's activities[193].

Otherwise, if the agent is merely engaged in executing activities of a supportive role of the principal's core activities, such as preparatory or auxiliary activities, this criterion will not be reached, and neither will the PE threshold[194].

In fact, this results directly from the wording of article 5 (5) 2014 OECDMC, which goes further to evidence the explained influence of article 5 (4) 2014 OECDMC on the DAPE concept[195].

Having determined the type of activity the agent needs to carry on, the following step is to verify if such activity is made on behalf of the principal, as otherwise, no PE exists.

This second element's analysis should be made jointly with the following criterion, as it relates to the authorization the enterprise conveys onto the agent to conclude contracts on its behalf, which may be conveyed either expressly or by posterior ratification of the contracts[196]. The agent should be seen as an extension of the enterprise.

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[193] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 33; HÄGGLUND, Camilla Berkesten – *The Definition of a Permanent Establishment in the BEPS Era: An analysis of the introduction of commissionaire structures in Article 5(5) of the OECD Model Treaty*. 2017. Uppsala. Master thesis. p. 19; KAROLYI, Balazs – *The Challenges of*… p. 32.

[194] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 33; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 387, 389; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 20; KAROLYI, Balazs – *The Challenges of*… p. 31; CALABRESE, Mattia – Chapter 5: Taxing… p. 7.

[195] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 389; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 28, 33; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 20; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 7.

[196] CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 5-6.

A relevant factor in this analysis is also to consider where the risk of the business activity lies and whether the agent supports the costs of its activity or if it is reimbursed of such costs, as that could suggest that the agent does not act on behalf of the enterprise[197]. Where the business activity's risk lies will be revealed as the crux of the DAPE's analysis.

The fact that the agent acts on behalf of the enterprise does not need to be public or communicated to whom the agent engages in its activities, meaning that the contracts are not required to be literally in the name of the enterprise[198]. In the same way, the DAPE status of an agent will not be precluded by the fact that the enterprise pays remuneration to the agent as consideration for the latter's activities on behalf of the former[199].

1.5.2.3. Exercises the authority to conclude contracts

Under this criterion, it is not enough that the agent simply acts on behalf of the enterprise, it is vital to have the authority to conclude contracts and that authority needs to be effectively exercised[200]. As referred to in the preceding point, the enterprise needs to convey to the agent the necessary authority to allow the latter to engage and conclude contracts on behalf of the former, even if informally[201].

Such authority naturally relates to the ability of the agent to bind the enterprise on the contracts concluded, or entered into, on its behalf (vis-à-vis third parties[202]), the mere presence of a dependent person in another country does not exceed the DAPE threshold, as the enterprise's business activity needs to have a strong enough link with the Source Country, therefore a considerably active role is required to fulfil this criterion[203].

A statement of the agent's authorization to conclude contracts and its exercise, leading to dependence, comes from a sporadic or almost non-existent follow-up on

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[197] RIBEIRO, Cláudio de Paiva – *A tributação do*… p. 13; XAVIER, Alberto – *Direito Tributário Internacional*… p. 342.
[198] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 387.
[199] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 385.
[200] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 387.
[201] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 33.
[202] In the following criterion we will explore this remark in further detail.
[203] CALABRESE, Mattia – *Chapter 5: Taxing* … p. 6; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 32-32.1.

the agent and the lack of participation of the enterprise in dealings negotiated in detail by the agent, even if the agent does not formally finalize the contracts or has a formal power of representation, as occurs in cases where the agent's dealings are routinely approved by the enterprise, thus binding[204]. In the following criterion, we will address the issue related to the binding effect vis-à-vis the enterprise.

As it can be inferred, the expression "conclude" needs to be considered and analysed in a broad sense and not literally, so long as it is still binding on the enterprise. Following the 2014 OECDMC Commentary, we favour an extensive interpretation approach on the analysis of this criterion, as it leads to less planning, and possibly avoidance, under which the contracts do not need to be literally concluded/signed by the enterprise[205].

The extent of the powers conferred by the enterprise is one of the elements to be taken into consideration in this analysis, as a mere arrangement or liaising of contractual negotiations may, by itself, be insufficient to state that the agent is exercising an authority to conclude contracts[206]. These analyses should always be rendered on a case-by-case basis and in consideration of the context of the dealings, as no two situations are alike and distortions may arise.

Upon validly concluding that an agent has authority, the point then shifts to the intensity with which said authority is exercised, the less intense, the less likely it is to fulfil this criterion.

1.5.2.4. In the name of the enterprise

This criterion is crucial and is also the one where there is more discussion between all relevant stakeholders within article 5 (5) 2014 OECDMC.

The discussion circles around the question of when an agent acts in the name of an enterprise in a binding way so that the DAPE threshold is reached. Various

[204] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 32.1, 33; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 387; PROXENOS, Jolani – *An analysis of*… p. 27.
[205] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 387; CALABRESE, Mattia – *Chapter 5: Taxing* … p. 6; HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 19; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 18; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 32.1, 33
[206] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 33; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 387.

positions arise in this subject suggesting different solutions for the fulfilment of this criterion, each entailing different thresholds, as suggestions point that the criterion could be reached by just having the enterprise's name in the contract, by being legally binding on the enterprise, or by being economic/*de facto* binding on the enterprise.

Obviously that there is no consensus on this discussion, as it may be demonstrated by a major split in this regard between Common Law and Civil Law[207][208].

This criterion's discussion is essentially the one that gave cause to the central role of article 5 (5) 2014 OECDMC in the context of Action 7, which will be properly analysed in the following Chapter. In any case, we will describe the discussion on this criterion and divulge our position on it, which will prove helpful in putting Action 7's outcome into perspective.

Inherent to the DAPE is the notion of representation, be it express or tacit, and this together with the notion of binding legal effect is the crux of the discussion.

The pivotal point of this dispute is indeed related to representation, but more specifically with the agent's to bind the principal before third parties[209]. This discussion resonates from the wording of article 5 (5) 2014 OECDMC vis-à-vis its first draft, where the initial expression was only "on behalf of", and later was replaced by "in the name of" [210], and also from the 2014 OECDMC Commentary on article 5 (5)[211].

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[207] Common Law legal orders are typical of countries strongly influenced by the UK tradition, while Civil Law legal orders are typical of countries influenced by Continental Europe's tradition.

[208] CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 6-7; EISENBEISS, Justus – *BEPS Action 7…* p. 491; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 22-23; AVERY JONES, John; LÜDICKE, Jürgen – *The Origins of Article 5(5) and (6) of the OECD Model*. World Tax Journal. October 2013, pp. 203-241.

[209] CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 6-7; TRACANA, Dinis –*The Effect of the OECD/G20 BEPS Initiative on the Attribution of Profits to Permanent Establishments: The Special Case of Agency Permanent Establishments*. Bulletin for International Taxation. Volume 71, number 3/4 (2017) p. 214; BARBIER, Casper – *The Permanent Establishment*… pp. 42-43.

[210] CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 6-7; PIJL, Hans – *Agency Permanent Establishments: in the name of and the Relationship between Article 5(5) and (6) – Part 2*. Bulletin for International Taxation. Volume 67, number 2 (2013) pp. 72-76, 96-97.

[211] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 32.1-33; XAVIER, Alberto – *Direito Tributário Internacional*… pp. 317-321, 341-342; EISENBEISS, Justus – *BEPS Action 7…* p. 491; PIJL, Hans – *Agency Permanent Establishments: in the name of and the Relationship between Article 5(5) and (6) – Part 1*. Bulletin for International Taxation. Volume 67, number 1 (2013) pp. 6-9, 13-15; AVERY JONES, John; LÜDICKE, Jürgen – *The Origins of*… pp. 203-241.

Where usually, from a Common Law perspective, the expression's change does not have much difference in the binding effect, as an agent binds the principal before third parties under both expressions, it is quite different from a general Civil Law perspective, since the agent only legally binds the principal before third parties when it is acting in the name of the principal, otherwise, when it is solely acting on behalf of the principal, only the agent is bound before third parties (*i.e.,* third parties cannot take direct legal action against the principal)[212].

This distinction originates from the fact that in Civil Law countries there are two separate legal concepts, the mandate with representation and the mandate without representation[213]. Under the typical Civil Law perspective, the former is generally associated with a dependent agent and the latter with an independent agent, as the first effectively acts in the name of the principal and binds it towards third parties and the other does not[214]. However, even between Civil Law countries, there is no consensus regarding the approach to take when analysing this criterion, a more formal/legal one or a more economical/substantive one[215].

As it results from the above, the Common Law approach usually leads to a broader scope of the DAPE concept, since in either scenario the principal tends to be bound by the dealings and contracts concluded by the agent[216]. Therefore, relevant arrangements put in place by an enterprise, such as commissionaire structures or similar, could still lead to a DAPE status in the Source Country[217].

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[212] CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 6-7; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 22-25; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 159-160; AVERY JONES, John; LÜDICKE, Jürgen – *The Origins of*… pp. 203-241; AUSTRY, Stéphane – *Chapter 12: PE and Dependent Agent: Where Do We Stand?* In MAISTO, Guglielmo ed. – *Current Tax Treaty Issues: 50th Anniversary of the International Tax Group*. Volume 18 of EC and International Tax Law Series. Books IBFD. 2020. pp. 477-478.

[213] As an example, articles 1178 and 1180 of the Portuguese Civil Code, respectively.

[214] XAVIER, Alberto – *Direito Tributário Internacional*… pp. 317-321, 341-342.

[215] EISENBEISS, Justus – *BEPS Action 7…* p. 485; CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 6-7; JIMÉNEZ, Adolfo J. Martín – *The Spanish Position on the Concept of a Permanent Establishment: Anticipating BEPS, beyond BEPS or Simply a Wrong Interpretation of Article 5 of the OECD Model?*. Bulletin for International Taxation. Volume 70, number 8 (2016) pp. 459-467; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 159-164; PIJL, Hans – *Agency Permanent Establishments* […] *Part 1*… pp. 6-9; AUSTRY, Stéphane – *Chapter 12: PE*… p. 480.

[216] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 32.1-33; CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 6-7; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 24-25; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 159-160.

[217] CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 6-7.

On the contrary, the traditional Civil Law approach will lead to a DAPE concept with a narrower scope, as only those agents that are capable of binding the principal vis-à-vis the clients can fulfil this criterion, and ultimately reach the DAPE status[218]. The very same structures that could give rise to a DAPE under the Common Law approach would not meet the requirements under this approach, such as commissionaires and similar arrangements[219].

The other Civil Law countries' approach relies on an economical and substance-over-form analysis under the DAPE concept, and especially of this criterion, arguing that the expression "bind" should be stretched from a strict legal logic to include an economical and factual bond between the enterprise and the clients[220].

Considering the above, it is clear that there is no common ground for a consensus on this matter, the legal orders and structures are too distinct and apart from each other.

Further, it is our understanding that the wording of both article 5 (5) 2014 OECDMC and its Commentary does not seem to allow any sort of substance-over-form approach aimed at providing other meaning to "bind" and "in the name of" other than the one that results from the legal interpretation of these legal terms, such substantive approach is not without critique and difficulties[221]. By doing so, it falls outside the general principles and guidance of interpretation and disregards the legal meaning of the concepts and the connection with the provision and its context[222].

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[218] *Ibid*; XAVIER, Alberto – *Direito Tributário Internacional*… pp. 317-321; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 32.1-33; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 24.

[219] XAVIER, Alberto – *Direito Tributário Internacional*… pp. 317-321; CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 6-7; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 24.

[220] JIMÉNEZ, Adolfo J. Martín – *The Spanish Position*… pp. 459-467; TRACANA, Dinis –*The Effect of*… p. 214; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 7; KAROLYI, Balazs – *The Challenges of*… p. 31; PIJL, Hans – *Agency Permanent Establishments*… pp. 6-9, 13-15.

[221] JIMÉNEZ, Adolfo J. Martín – *The Spanish Position*… pp. 459-467; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 24-25; PIJL, Hans – *Agency Permanent Establishments*… pp. 6-9, 13-15; JIMÉNEZ, Adolfo J. Martín – *Preventing the Artificial Avoidance of PE Status* In *Papers on Selected Topics in Protecting the Tax Base*. September 2014. pp. 61-70. Available at: https://www.un.org/esa/ffd/wp-content/uploads/2014/09/20140923_Paper_PE_Status.pdf

[222] As foreseen under articles 31 to 33 VCLT; JIMÉNEZ, Adolfo J. Martín – *The Spanish Position*… pp. 459-467; LANG, Michael; BRUGGER, Florian – *The role of*… pp. 96-100, 107-108; BRAVO, Nathalie – *Interpreting Tax Treaties in the Light of Reservations and Opt-Ins under the Multilateral Instrument*. Bulletin for International Taxation. Volume 74, number 4/5. (2020) pp. 234-235; PIJL, Hans – *Agency Permanent Establishments*… pp. 6-9, 13-15.

Although not in agreement, we tend to sympathize with this approach on the merits of the outcome, however, there are other, perhaps even more suiting means to reach the same result, *i.e.* combating abusive planning and structuring, such as the application of anti-abuse rules[223].

Having considered all approaches in the context of our Portuguese legal framework, and well aware of the outcome of our stance, we follow the traditional Civil Law approach on a legal interpretation of the relevant terms considering both the wording of the provision and the 2014 OECDMC Commentary on it, which may lead to a narrower scope and increased exposure to planning and avoidance, with the inherent divergent practice with Common Law countries and some Civil Law countries[224].

In this sense, our stance on this criterion is that it will be fulfilled whenever the agent concludes, or enters into, contracts that are legally binding on the enterprise vis-à-vis the clients, thus possibly giving rise to a DAPE contingent on the verification of the other criteria, resorting to "in the name of" as a term of art for Civil Law countries and not its strict literal interpretation nor a distorted economic logic.

In our view, there is a clear distinction between an extensive interpretation of provisions, which is still linked to the wording, legal effect of the provisions and its purpose, and the economical/substance-over-form approach, under which it is arguable if there still is such a link or if it even is in line with the provision's purpose. Anti-abuse concerns should not jeopardize the legal framework on which legal systems stand.

There is an intrinsic relation between this criterion and the one that precedes it; therefore, they should be jointly analysed, meaning that both ought to be fulfilled when the agent has, and exercises, the authority to conclude, or enter into, contracts that are legally binding on the enterprise.

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[223] JIMÉNEZ, Adolfo J. Martín – *Preventing the Artificial*… pp. 67-71; JIMÉNEZ, Adolfo J. Martín – *The Spanish Position*… pp. 459-467.

[224] Following articles 31 to 33 VCLT; LANG, Michael; BRUGGER, Florian – *The role of*… pp. 96-100, 107-108; BRAVO, Nathalie – *Interpreting Tax Treaties*… pp. 234-235; PIJL, Hans – *Agency Permanent Establishments […] Part 2*… pp. 96-97.

Although these criteria are cumulative, this criterion tends to stand out from the bunch due to its exposure to misinterpretations and mismatches between countries.

The subsequent criterion seeks to assess a fundamental characteristic of the enterprise's activity through the agent in the Source Country, the recurrence of the activity.

1.5.2.5. Habitually

Being a common trace for the criteria on the DAPE, this criterion also relates to a sense of the intensity of the agent's activity in the Source Country vis-à-vis the principal, meaning that it is unlikely that the DAPE threshold is reached where the agent only sporadically or ephemerally exercises the authority to conclude contracts in the name and on behalf of the enterprise in that country[225].

It is the regular and recurring exercise of contracting authority that establishes the nexus between the Source Country and that specific enterprise, triggering a DAPE therein[226]. As we will see, the habitual exercise of such authority by an agent concerning more than one enterprise might preclude the DAPE status[227].

This criterion is the DAPE's take on the *situs* and *tempus* test of the physical PE, *i.e.* a sense of stability and permanence within the Source Country, with the twist that the agent might not even be a resident or citizen of the Source Country[228]. The mere physical local presence of the agent regularly exercising its contracting authority on behalf of the same enterprise suffices[229].

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[225] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 32, 33.1; XAVIER, Alberto – *Direito Tributário Internacional*… p. 322; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 6; FEUERSTEIN, David – *The Agency Permanent Establishment* In LANG, Michael; BRUGGER, Florian; PLANSKY, Patrick eds. – *Permanent Establishments in International and EU Tax Law*. Series on International Tax Law Volume 68. Wien: Linde. 2011. p. 115.

[226] XAVIER, Alberto – *Direito Tributário Internacional*… p. 322; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 388; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 32, 33.1; PROXENOS, Jolani – *An analysis of*… p. 28; FEUERSTEIN, David – *The Agency Permanent*… p. 115.

[227] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 388; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.6.

[228] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 388; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 33.1; FEUERSTEIN, David – *The Agency Permanent*… pp. 116-117.

[229] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 388; FEUERSTEIN, David – *The Agency Permanent*… pp. 116-117.

The criterion "habitually" entails an inherent sense of measurement, meaning how much is the enterprise effectively conducting its business activity in the Source Country via an agent with contracting authorization in its name and on its behalf. Gauging this criterion is rather complex as it relates to the extent and frequency of the exercised activity and no guidance is provided on this assessment, for instance, by contrast with the project PE (12-month period)[230].

Furthermore, establishing a fixed and objective standard for frequency and extent to measure the enterprise's activity in the Source Country via the agent would be impossible, or at the very least inadequate and synthetic, as it could not be considerate of the multitude of nuances that exist between the different business activities in a global economy[231].

In this regard, this criterion demands a subjective analysis that considers the nature and context of the contracts and the enterprise's business, because the scale used to gauge the activity of a retailer cannot be the same one used to gauge the activity of a major real estate investment fund[232].

Therefore, and similar to the other criteria, it is paramount that this criterion is examined on a case-by-case basis and placing the agent's exercise of contracting authority into perspective, *i.e.* the nature of the contracts and the overall business of the enterprise[233].

With this criterion, we have completed the DAPE concept's set of criteria that require a positive analysis. The outstanding criterion differs from the rest in the way that it will be fulfilled, possibly giving rise to a DAPE when a negative answer is achieved.

1.5.2.6. Without having an independent status

The criteria addressed up until this point establishes the core of the DAPE concept. However, although the criteria are cumulative and equally relevant,

[230] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 33.1.
[231] *Ibid;* FEUERSTEIN, David – *The Agency Permanent*… p. 115.
[232] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 33-33.1; FEUERSTEIN, David – *The Agency Permanent*… p. 115.
[233] *Ibid*; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 19.

according to our opinion, this concept will only be complete when it is shrouded by this final and important criterion, as a Christmas gift outside Christmas.

As mentioned, herein we seek a negative response to fulfil this criterion, given that the wording of article 5 (5) 2014 OECDMC is stipulated *a contrario*, *i.e.* only when the agent does not have an independent status may a DAPE be deemed to exist vis-à-vis the principal[234].

Additionally, not only does the wording of article 5 (5) 2014 OECDMC mentions an agent of an independent status, as it even goes further and emphasizes that that agent should qualify under article 5 (6) 2014 OECDMC.

The essence of this criterion lies in assessing the degree of dependence of the agent vis-à-vis the enterprise, a pillar on the DAPE concept and a feature that is shared with article 5 (6) 2014 OECDMC even though these articles pursue opposite outcomes, one aims at having the PE status and the other to elude it. Consequently, the distinction between dependent agent and independent agent is paramount[235].

On this note, it is important to establish the exact relationship between article 5 (5) and (6) 2014 OECDMC and how it will affect the analysis of this criterion. We note that there are different positions on this matter with significant impact on it, so we will present the relevant theories and reveal our stance on the debate, as it will guide our work henceforth.

We acknowledge the existence of three main theories regarding the relationship between article 5 (5) and (6) 2014 OECDMC. The first theory claims that both articles are independent of each other and that both may give rise to a DAPE; the second theory maintains that article 5 (6) 2014 OECDMC is an exception to article 5 (5) 2014 OECDMC, in the sense that article 5 (6) operates as an insurance against the qualification as a DAPE where the other tests under article 5 (5) 2014 OECDMC are met; and the third theory argues that article 5 (6) 2014 OECDMC is a rule to be included into article 5 (5) 2014 OECDMC, meaning that it should be the first test to be analysed[236].

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[234] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 32, 36; XAVIER, Alberto – *Direito Tributário Internacional*… pp. 341-342; PIRES, Rita Calçada – *Manual de Direito*… p. 85.
[235] XAVIER, Alberto – *Direito Tributário Internacional*… pp. 341-342; FEUERSTEIN, David – *The Agency Permanent*… p. 117.
[236] GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 25-26; PROXENOS, Jolani – *An analysis of*… pp. 29-30; CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 7-8; PIJL, Hans – *Agency*

Based on our initial comments regarding this criterion, we do not adhere to the first theory and respectfully disagree with it based on the following aspects. Article 5 (6) 2014 OECDMC seeks to reduce the scope of the DAPE and not to expand it, moreover, the express purpose of this article is to highlight and dismiss doubts on the type of agents that may constitute a DAPE, it is not its purpose to be another PE deeming provision.

Also, the scope of article 5 (6) 2014 OECDMC would be rather wide as it does not provide or contemplates a sufficient nexus between the enterprise's activities and the Source Country (a certain permanence therein), resulting in questionable existence of any criterion for its application and not in line with the general purpose of article 5 2014 OECDMC and its Commentary[237]. This theory seems to be supported by a doubtful basis other than *a contrario* reasoning of this article[238].

From a practical outcome perspective, the second and third theory are quite similar, both argue that the purpose of article 5 (6) 2014 OECDMC is to exclude from the DAPE concept agents of independent status[239]. However, the method to reach this outcome is substantially different[240].

An exception naturally operates by excluding something that meets all other necessary requirements for a qualification, it is a final *in extremis* test, the last bastion before a consequence, in our case a deemed DAPE status. This is precisely the logic advocated by the second theory, which we do not follow and humbly disagree with.

This second theory leads to a vital question related to the examples of article 5 (6) 2014 OECDMC that ties with our explanation, and position, on the interpretation of "in the name of". According to our understanding, to be deemed to qualify as a DAPE, the agent's exercise of contracting authority needs to legally bind the

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Permanent Establishments […] *Part 1*… pp. 4-5; PIJL, Hans – *Agency Permanent Establishments* […] *Part 2*… pp. 84-96; FEUERSTEIN, David – *The Agency Permanent*… p. 110.

[237] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 36; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 8; PIJL, Hans – *Agency Permanent Establishments* […] *Part 1*… pp. 9-10; PIJL, Hans – *Agency Permanent Establishments* […] *Part 2*… pp. 95-97.

[238] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 36; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 8; PIJL, Hans – *Agency Permanent Establishments* […] *Part 1*… pp. 9-10; PIJL, Hans – *Agency Permanent Establishments* […] *Part 2*… pp. 89, 95-97.

[239] CALABRESE, Mattia – *Chapter 5: Taxing*… p. 8; PIJL, Hans – *Agency Permanent Establishments* […] *Part 1*… pp. 9-10; PIJL, Hans – *Agency Permanent Establishments* […] *Part 2*… pp. 93-94.

[240] *Ibid*.

enterprise. However, a broker or a general commission agent do not legally bind an enterprise since these legal figures do not rely on a mandate with representation.

As such, it strikes us as odd how could a broker or a general commission agent fulfil the other criteria of article 5 (5) 2014 OECDMC so that the exception could apply, when in fact they never could, thus the reference to them would be pointless[241].

This theory rests on the logic that article 5 (6) 2014 OECDMC would apply in the same manner as article 5 (4) 2014 OECDMC applies by reference to the physical PE concept, *i.e.* all criteria for it to be deemed to exist are verified but, in the end, due to their qualification under the exception article, the PE status is precluded[242]. In the situation under analysis, this would lead to the reasoning that a broker or general commission agent (incapable of legally binding the principal) would fulfil all article 5 (5) 2014 OECDMC's criteria before the application of this criterion.

This theory leads to further divergent practice between Common Law and Civil Law countries which is one of the major shortcomings of this theory and one that its authors recognize, leading to question the consistency of the article's relationship[243].

The main flaw in this reasoning is in its core assumption that the relationship between article 5 (5) and (6) 2014 OECDMC truly is that of a main provision-exception. However, it is a wrong premise for this theory, as it does not have strong support on the wording nor the Commentary of article 5 (5) and (6) 2014 OECDMC, and it has blunt difficulties vis-à-vis Common Law and Civil Law countries[244].

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[241] GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 25-26; CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 7-8; PIJL, Hans – *Agency Permanent Establishments* […] *Part 1*… pp. 9-10; PIJL, Hans – *Agency Permanent Establishments* […] *Part 2*… pp. 94-95; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 391

[242] GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 25; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 8; PIJL, Hans – *Agency Permanent Establishments* […] *Part 1*… pp. 9-10; PIJL, Hans – *Agency Permanent Establishments* […] *Part 2*… pp. 94-95.

[243] CALABRESE, Mattia – *Chapter 5: Taxing*… p. 8; PIJL, Hans – *Agency Permanent Establishments* […] *Part 1*… pp. 9-10; PIJL, Hans – *Agency Permanent Establishments* […] *Part 2*… pp. 94-95.

[244] CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 7-8; PIJL, Hans – *Agency Permanent Establishments* […] *Part 1*… pp. 9-10; PIJL, Hans – *Agency Permanent Establishments* […] *Part 2*… pp. 94-95.

By contrast, the third theory advocates that the true relation between these provisions is one of integration, meaning that this criterion should be the first one analysed for the DAPE concept instead of being the last[245].

Through this theory, it is possible to overcome the second theory's inability to provide for a single and coherent application under Common Law and Civil Law countries, and at the same time, it is the one most compliant with the OECDMC (considering the historic evolution, the wording and the Commentary) and its purpose[246].

As established, a broker or general commission agent cannot give rise to a DAPE, as cannot any other agent of independent status of which those legal figures are an illustration. Hence, there is no cause to advance to article 5 (5) 2014 OECDMC's criteria where the agent in the relevant situation qualifies under article 5 (6) 2014 OECDMC. This is also the most logical and natural approach considering the wording of article 5 (5) 2014 OECDMC.

Therefore, this criterion will be the first one to be verified in the assessment of the DAPE status and it is done so via article 5 (6) 2014 OECDMC. Bringing back our Christmas gift example, if it is not Christmas it is not a Christmas gift, but it still is a gift; *mutatis mutandis* if the agent has an independent status it is not a dependent agent, but it still is an agent.

Considering all the above, we adhere to and support the third theory, as it leads to a more soothing relation between the provisions and their more adequate application vis-à-vis their interpretation in the context of their wording and the 2014 OECDMC.

Furthermore, in a DAPE potential case, upon concluding the independence/dependence analysis as per article 5 (6) 2014 OECDMC, its outcome is automatically conveyed to article 5 (5) 2014 OECDMC without further work and the other DAPE's criteria analysis will be contingent on the said outcome.

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[245] PROXENOS, Jolani – *An analysis of*… pp. 29-30; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 8; PIJL, Hans – *Agency Permanent Establishments* […] *Part 1*… pp. 4-5; PIJL, Hans – *Agency Permanent Establishments* […] *Part 2*… pp. 84-96.

[246] CALABRESE, Mattia – *Chapter 5: Taxing*… p. 8; PIJL, Hans – *Agency Permanent Establishments* […] *Part 1*… pp. 4-5; PIJL, Hans – *Agency Permanent Establishments* […] *Part 2*… pp. 84-96.

The mere fact that an agent does not have an independent status does not immediately translate into being deemed a dependent agent and reaching the PE status, all other criteria still need to be met.

As per the above, considering our position on the relationship between article 5 (5) and (6) 2014 OECDMC, it is more fitting to tackle the fulfilment of this criterion within our subsequent examination of article 5 (6) 2014 OECDMC.

Regardless, as we will explain, the dependence of the agent is fundamentally ascertained by gauging the functional integration between enterprise and agent, resorting to who really bears the risks of the activity carried out, which entails both a legal and economic outlook.

1.5.3. Qualification

In this respect, after the agent qualifies as truly dependent and constitutes a DAPE of the enterprise, the extent of this status encompasses all situations where the agent acts on behalf of that enterprise and not just the situations where it exercises contracting authority in the name and on behalf of the enterprise, but not extending to the agent's own business activities or the ones rendered on behalf of other enterprises, each relation agent-enterprise is independent under article 5 (5) 2014 OECDMC[247].

Moreover, the same agent can have more than one status vis-à-vis different enterprises, meaning that the same agent might constitute a DAPE of an enterprise on behalf of which it exercises contracting authority and not regarding another enterprise, *e.g.* the agent has an independent status in relation to the latter[248]. Once again, analysis on a case-by-case basis and each situation based on its own merits and facts.

It is also noteworthy that, for the person that reaches the DAPE status in the Source Country, there is no true difference in terms of its qualification or impacts under the 2014 OECDMC by comparison to the physical or project PE status, all fall under the same general umbrella[249].

[247] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 34.
[248] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 392-393.
[249] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 384.

As we have seen in this section, the DAPE status arises when an enterprise is deemed to have a strong enough presence in the Source Country resulting from a non-independent agent's habitual exercise of contracting authority in the name and on behalf of the former. This status means that the Source Country will have taxing rights over the related business profits, which in its turn signals neutrality in respect to a person's choice over the method for cross-border ventures[250].

The various elements that we have addressed herein provide only guidance for the analysis that needs to be conducted on each case as it may appear, also, upon concluding that the agent is not independent there is no other criterion that is decisive for the existence of a DAPE, such status only arises from the combination of the criteria.

Also, as opposed to the other provisions, article 5 (5) 2014 OECDMC has a strong subjective connotation about the enterprise's activity and the agent's habitual exercise of contracting authority, and both should be placed in proper context. The concept of DAPE, and its study, is not as straightforward as the physical and project PE.

In the subsequent section, we will examine article 5 (6) 2014 OECDMC, which is an integral part of the DAPE and directly relates to a vital criterion of it, meaning that only upon concluding the examination of such provision is it possible to accurately evaluate if the threshold for this status was reached.

1.6. Article 5 (6) 2014 OECDMC

In our probe on the DAPE concept it is obvious that the distinction between independent and dependent agents is vital, as such we will advance onto article 5 (6) 2014 OECDMC that establishes the independent status of an agent and the elements to assess such status:

"*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*

[250] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 31; EISENBEISS, Justus – *BEPS Action 7…* p. 485; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 5.

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."[251]

Following from the stated in the preceding section, the essential purpose of article 5 (6) 2014 OECDMC is to provide further clarity and highlight the exclusion of independent agents from constituting a PE since not all relationships between enterprises and persons justify this status[252].

Article 5 (6) 2014 OECDMC expressly states that brokers and general commission agents have an independent status provided that they act in the ordinary course of their business. The express reference is illustrative for a comparison between the activity of the relevant agent and that of those legal figures. Moreover, as we have seen, such examples are innocuous for Civil Law countries as these legal figures cannot bind the enterprise, but it is helpful for Common Law countries.

From the wording of the article, it is possible to deduce this article's vital elements: the independence of the agent and that the agent acts in the ordinary course of its business. With effect, the independence of an agent regarding the enterprise on whose behalf it acts will be judged both from a legal and economical perspective, and the agent when acting on behalf of that enterprise should do so in the ordinary course of its own business[253].

The outcome of the combined assessment of these elements will reveal if an agent qualifies for the independent status, or on the contrary, if it will have to go through article 5 (5) 2014 OECDMC's scrutiny and possibly giving rise to a DAPE.

The nature of this article and its parameters provide for an essentially subjective analysis; therefore, its outcome cannot be blindly binary, independent or not independent, it lives of degrees, providing guidance to precisely gauge the exact

[251] OECD – *Model Tax Convention*… 2014.
[252] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 36; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 390; KAROLYI, Balazs – *The Challenges of*… p. 32.
[253] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 37; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 390-391; XAVIER, Alberto – *Direito Tributário Internacional*… pp. 341-342.

level of independence an agent has in each situation[254]. The higher the level of independence the more likely it is to elude the DAPE status.

Notwithstanding, considering that the effects of the outcome are the preclusion of the DAPE status, the independence status should be deemed to be verified when there is no shadow of a doubt considering all elements and circumstances. Otherwise, it ought to be deemed as not independent and be subject to article 5 (5) 2014 OECDMC's tests.

Obviously, the heart of the matter lies in the relationship between the enterprise and the agent that represents it. Also, the independence status takes into consideration the functional integration of the agent in the enterprise's business. The more one agent is truly integrated within the enterprise's business, the less legal and economic independent the agent is and the less it acts in the ordinary course of its activity.

Our general explanation on article 5 (6) 2014 OECDMC essentially concludes that there are two tests to be met to reach the independent status, the independence test and the ordinary course test, and each bears several elements to determine their verification. Also, as we will demonstrate, some elements do not provide a clear-cut answer, instead, they provide guidance to navigate within a set bandwidth for each element[255].

It is relevant to recall that the independent agent status of article 5 (6) 2014 OECDMC lays on a positive qualification, meaning that this status' threshold needs to be overcome for an agent to qualify as such. Logically, this extends to the status' tests that we will describe. On the contrary, as the elements and tests are cumulative, should the agent fail to overcome at least one of the tests' elements, and hence the test itself, the independent agent status will be precluded.

1.6.1. Independence

Further to the above on this matter, the independence test relies on a two-pronged approach that entails a legal test and an economical test. These tests are

[254] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 391; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38-38.8.
[255] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.2.

cumulative, hence only when both are verified may an agent be deemed to have independent status[256]. Likewise, the independence test does not stand alone on the recognition of the independent status, it too is cumulative with the ordinary course test.

Also, since a broker and a general commission agent are assumed to automatically comply with this test, they are outside its scope, leaving within it all other agents. As a result, brokers and general commission agents are only subject to the second test, the ordinary course test.

Although not under review in the independence test, a broker and a general commission agent are still of use within it, as both are illustrative of the independent status of an agent. Based on the typical characteristics of both legal figures, we gather additional guidance for this test, including the legal relationship, the powers conveyed, the remuneration and its computation[257].

Customary to the analysis conducted within the DAPE concept, this test's analysis should also be conducted following a case-by-case approach in view of the context surrounding the enterprise-agent endeavours, for instance regarding the size of the undertaking.

Further to the above, this test splits into two fundamental tests, which may individually jeopardize the qualification as independent agent. Both the legal and economic tests are comprised of various elements, each providing guidance on the fulfilment of the test. We will be addressing each test considering its connection to the independence of the agent bearing in mind their elements.

1.6.1.1. Legal independence

The legal test in the independence test is multi-layered, comprising several elements pursuant to the legal relationship between agent and enterprise, it focuses on features such as the number of instructions and guidance from the enterprise to the agent.

[256] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 391.
[257] *Ibid*.

Before entering into further detail on this element, it is relevant to point out that between a parent company and its subsidiary there is an intrinsic legal control of the former over the latter. Nonetheless, we highlight that such legal control, *per se*, is irrelevant when evaluating an agent's dependence/independence under this test[258].

As we will see, article 5 (7) 2014 OECDMC is adamant on the independent analysis of each company, regardless of the group relation. Notwithstanding, as we will explain in the following section, a subsidiary may still constitute a DAPE of its parent company, or vice-versa, since the tests apply to these entities similarly to any unrelated companies and they could meet the requirements to reach such status[259].

The natural legal control present between related entities is irrelevant and it also provides a hint on the scope of the legal independence test. It is clear that the DAPE concept relies on the relationship agent-enterprise, and at the same time, the natural legal control of a parent over its subsidiary is not taken into account in the analysis of the legal independence test.

For the legal test, the relevant relationship between agent and enterprise is the contractual relationship put in place between both parties for the carrying on of the relevant activity, it is from this relationship that the relevant elements of this test emanate to pass, or not, the legal independence test[260]. Considering the contractual relationship between both parties, the nature of the obligations that the agent has before the enterprise hints at the agent's autonomy and independence[261].

Therefore, it is crucial to analyse the extent of the agent's obligations and responsibilities vis-à-vis the enterprise in the execution of the relevant activity, since the more comprehensive these are the less probable it is for the agent to be independent from the enterprise, on the contrary, where the agent has substantial

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[258] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.1; KAROLYI, Balazs – *The Challenges of*… p. 32; MONSENEGO, Jérôme – *The Independent Agent Exception and Group Membership*. Intertax. Volume 46, issue 12 (2018) p. 947.

[259] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.1, 41; KAROLYI, Balazs – *The Challenges of*… p. 32.

[260] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38-38.1; MONSENEGO, Jérôme – *The Independent Agent*… pp. 947-949.

[261] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38-38.3; MONSENEGO, Jérôme – *The Independent Agent*… pp. 947-949; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 392.

leeway in the execution of the activities and relies on its skills and knowledge, the independence status is more likely[262].

As per the 2014 OECDMC Commentary on article 5 (6), where an agent in the execution of the enterprise's activities is subject to comprehensive control or detailed instructions by the latter, it cannot be regarded as an independent agent[263]. However, this feature should be distinguished from the mere provision of information from the principal to the agent, or vice-versa, as the agent is still conducting the principal's activity.

In this sense, and based on the characteristics of the relevant activity, the information the principal relays on the agent necessary for the execution of the activities (*e.g.*, basic information of the activity, quality standards, establishing the intended result) is not enough in itself to determine the agent dependency[264]. Similarly, the information the agent provides the principal about the activity carried out is not sufficient in itself to ascertain the dependence, provided that the agent is not seeking approval concerning the execution of the activity[265].

The relevance of the extent of the contractual obligations on the assessment of the legal independence results from the fact that the independent agent is bound before the principal in relation to the result of the activity, and not in the way such activity is conducted (with the principal relying on the agent's skill and knowledge), *i.e.* the fundamental distinction between obligation of means or of outcome plays a key role herein[266].

An indication of the agent's independence can be found where the contractual relationship between both parties is set on the outcome of the agent's activity on behalf of the principal and the former's autonomy and freedom to conduct it as it

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[262] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38, 38.4; MONSENEGO, Jérôme – *The Independent Agent*… p. 947; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 392; XAVIER, Alberto – *Direito Tributário Internacional*… pp. 341-342; FEUERSTEIN, David – *The Agency Permanent*… pp. 118-119.

[263] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.

[264] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.5; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 9; FEUERSTEIN, David – *The Agency Permanent*… pp. 118-119.

[265] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.5; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 9.

[266] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.3; PIRES, Rita Calçada – *Manual de Direito*… p. 86.

sees fit based on the authority conferred by the principal, bearing in mind the scale of business at hand[267].

In contrast, where the principal exerts significant influence and control over the agent, a strong indication of dependence arises, for instance, where the agent is integrated within the principal as an employee, director or partner and subject to orders and rules of the principal, the leeway such agent has is minimal if any[268].

From the above it is possible to grasp the content of the legal independence test, the several elements it contains and the indications it provides when considering the independence of an agent. It is from the combination of all elements that it is possible to reach a judgement on the fulfilment of this test, with the nuances proper of subjective analysis. For an agent to meet this test, it should have clear control over the execution of his activity, proper of an obligation of outcome, regardless of certain minor reporting obligations or quality standards[269].

However, an agent's independence is not reached by merely fulfilling the legal test, this is a two-pronged test, and it requires an in-depth analysis of the economic aspect of the agent-principal relationship. Only when an agent passes both tests may it reach the independent status.

1.6.1.2. Economic independence

The economic test is the second half of the independence test. This test shares some similarities with the legal test regarding the role of the relationship between agent and principal but now focused on the economic aspect of it instead of the legal obligations and responsibilities that emerge from it.

This test goes beyond the mere relationship between the agent and an enterprise, it considers the agent's whole activity by reference to that enterprise, namely regarding the number of principals the agent has, and the allocation of risk between both parties.

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[267] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.3-38.4; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 9; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 392; XAVIER, Alberto – *Direito Tributário Internacional*… pp. 341-342; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 21.

[268] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 392; MONSENEGO, Jérôme – *The Independent Agent*… pp. 948-949.

[269] GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 22.

A strong indication that an agent is independent derives from the computation of its remuneration for carrying out the enterprise's activity. This occurs when the agent's compensation is linked with the result of the execution of the activity, being the computation made on a profit-based approach, which usually leads to a non-fixed fee as the agent's compensation[270]. In opposition, a dependent agent tends to have a fixed salary, with limited, or no connection, with the result of its activity on behalf of the principal[271].

Additionally, the allocation of the venture's risks is a key element in the analysis of the economic independence of the agent vis-à-vis the enterprise. An independent agent should bear a significant share of the risk of the business it carries out and not the principal, which should only bear a marginal share of the risk[272].

Several indications arise in respect of the allocation of the venture's risk, such as the computation of the agent's remuneration, the leeway it has in the execution of the activity, the consequences of the lack of sufficient profits, or even losses, from the activity, meaning whether or not the agent is reimbursed and compensated by the enterprise as a result of it[273].

An independent agent should bear the consequences of its ventures when they are less successful and collect the rewards due in proportion to the success achieved through the execution of the relevant activity[274].

Furthermore, another element to consider when analysing the economic test is the number of principals an agent has. This is a *sui generis* element considering it relates to both the legal and the economic test, however, in our view, its relevance from an economic independence perspective supplants the legal one.

As prescribed by the 2014 OECDMC Commentary on article 5 (6), it is more difficult for an agent to reach independent status where its activities are carried out

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[270] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 392; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 9; XAVIER, Alberto – *Direito Tributário Internacional*… p. 341.
[271] XAVIER, Alberto – *Direito Tributário Internacional*… p. 342.
[272] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 9; XAVIER, Alberto – *Direito Tributário Internacional*… pp. 341-342; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 21, FEUERSTEIN, David – *The Agency Permanent*… p. 121.
[273] CALABRESE, Mattia – *Chapter 5: Taxing*… p. 9; FEUERSTEIN, David – *The Agency Permanent*… p. 121.
[274] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.6; FEUERSTEIN, David – *The Agency Permanent*… p. 121.

wholly, or almost wholly, on behalf of a single enterprise over the lifetime of the business or a long period of time, but this is not decisive[275]. This element serves as an indication of dependence, which can either be confirmed or repealed considering all other elements.

Unfortunately, there are no details or guidelines over what should be understood as "almost wholly" or "a long period of time", thus giving rise to concerns on the distinctions, especially considering differing business sectors.

This element, investigated in connection with the previous ones, provides guidance on the fulfilment of the economic test. An independent agent should secure its economical survivability and increase its revenue and business, which tends to be achieved by performing activities on behalf of more than one enterprise and not by being limited to a sole enterprise[276].

Considering the economic aspect of the number of principals, it is less probable that an agent is independent where its survivability depends on just one enterprise, or when the income from one enterprise clearly supersedes the income that that agent receives from the remainder of the enterprises on whose behalf it acts[277].

From a legal perspective, it is expected that an independent agent is engaged by more than one enterprise, thus eroding the control and influence the enterprises might place over the agent, based on the agreements entered into between the parties, as it is common with brokers or sports agents. Notwithstanding, the agent might fail the legal independence test when it is engaged by multiple enterprises, none of them is predominant within the former's business, but these enterprises together control the agent's activities on their behalf in a coordinated fashion amongst them[278].

As mentioned, these elements are merely indicative, they are not a presumption of dependence or independence, and their analysis should always be made taking into account the particularities of the relevant activity, *e.g.* sector-specific methods

[275] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.6.
[276] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.6; MONSENEGO, Jérôme – *The Independent Agent*… p. 950.
[277] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.6; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 9. REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 392.
[278] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.6.

of conducting an activity[279]. It may be the case where, in a specific sector, it is customary that an agent is engaged by a sole enterprise.

From the combined analysis of these elements, it is possible to comprehend the economic aspect of the independence test, which is essentially linked to the existence of the agent vis-a-vis its principal, an independent agent should be able to stay in business, and expanded it, by itself through the activities it performs on behalf of others and supports the inherent risk of being in business.

A common feature for both the legal and economic test is that their examination should always be conducted considering all facts and circumstances in play, it is a subjective approach that needs proper context to reach a true and adequate outcome on the fulfilment of the independence test[280].

Clearly, an agent's qualification as independent within a certain sector does not necessarily lead to the very same conclusion about a different sector, diamonds are different from sportspersons, from beans, from televisions, from financial assets and so on. Furthermore, these tests require a positive qualification to be met, therefore, an agent needs to meet these tests and elements, without doubt, to qualify as an independent agent.

The agent should be functionally independent from the enterprise, both legally and economically, to be able to qualify as an independent agent, not abiding by rules and regulations of the enterprise regarding the means to conduct the business, bearing its own activity's risk and being rewarded for its own success accordingly, hence having its own business, although on behalf of the principal[281].

The independence test establishes the true nature of an agent in a given situation, as it is based on a multitude of interconnected elements that give rise to two cumulative tests[282].

The analysis of these elements and tests is not straightforward and it has several nuances, varying within business activities. Still, these tests provide the clarity needed to determine the agent's independence/dependence, which is key in either

[279] *Ibid*; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 9.
[280] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.6.
[281] XAVIER, Alberto – *Direito Tributário Internacional*… pp. 341-342; FEUERSTEIN, David – *The Agency Permanent*… p. 121.
[282] GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 22.

reaching the independent agent status or having to go through article 5 (5) 2014 OECDMC's examination.

In light of the above, it is possible to ascertain if an agent qualifies as independent and if it gets one step closer to the independent agent status. Yet, before qualifying for such status, the agent must still overcome the ordinary course test, as an agent may be independent but not reach the independent agent status if the activities it performs are not within the ordinary course of its own business.

1.6.2. Ordinary course

The ordinary course test is the last test an agent needs to meet to reach the independent agent status, which in its turn means that the enterprise that engages such agent will not be deemed to have a DAPE in the Source Country. This test also marks the first, and only, exam that brokers and general commission agents are subject to, as they are deemed to be independent by nature.

It is important to retain that, during the analysis of the ordinary course test the relevant agent already qualified as independent, considering that the agent is only subject to this test when it passes the previous one[283].

As a result, the independence *per se* of the agent is no longer under discussion. What is under review in this test is if the independent agent is acting in the ordinary course of its own business, or if it is acting in the enterprise's business in such a way that precludes its qualification as an independent agent under article 5 (6) 2014 OECDMC[284].

Therefore, it is important to retain that this test focus on the ordinary course of the agent's business, which must be distinct from the enterprise's business for this test to be fulfilled. This will not be the case where an agent performs activities that are part of the enterprise's economic sphere and not of its own, such as in situations where, by reference to the same enterprise, a commission agent sells goods in his

[283] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 392.
[284] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 392-393.

own name and also habitually acts as a permanent agent of the enterprise exercising contractual authority[285].

In this scenario, the commission agent could be deemed to be a DAPE of the principal by reference only to that particular activity that is outside the scope of its ordinary course of business, which is that of a commission agent[286].

Moreover, examining if the relevant activity is being conducted within the ordinary course of the agent's business activity is once again a fundamentally subjective analysis that should take into consideration the context and economic sector in which the enterprise and the agent are inserted, otherwise, objective and agent-centred (those that only consider the relevant activity and the agent's other activities) solutions would lead to distortions within the same sector, and possibly by reference to the same agent, in relation to the DAPE concept[287].

The relevant activity performed by the independent agent should be viewed against the regular activities carried out by comparable agents in the same sector, when they are aligned, the agent's activity is in the ordinary course of its activity and hence qualifies as an independent agent under article 5 (6) 2014 OECDMC, *e.g.* a sportspersons' agent that negotiates a contract in the name and on behalf of its principal for a new club, or a commission agent who negotiates a contract in the name and on behalf of its principal for the supply of the latter's merchandise[288].

By contrast, if the same sportspersons' agent negotiates in the name and on behalf of a principal for the supply of cattle to a farm, this activity likely fails this test, as the supply of cattle is not the ordinary course of that agents' business.

Nonetheless, this comparison might be insufficient to validate whether the independent agent's activity on behalf of the enterprise is truly in the customary course of its business, as do the other activities the agent carries on, *e.g.* if the activity does not relate to a common business. In these situations, additional or alternative

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[285] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.7; XAVIER, Alberto – *Direito Tributário Internacional*… p. 342.
[286] *Ibid*; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 392-393.
[287] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.8; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 9; KAROLYI, Balazs – *The Challenges of*… p. 32; FEUERSTEIN, David – *The Agency Permanent*… pp. 122-123. In contrast: REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 393, which upholds an analysis based on the ordinary activities of the agent and not those of its sector.
[288] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.8; FEUERSTEIN, David – *The Agency Permanent*… pp. 122-123.

tests should be conducted to assess if the agent is indeed within a truly independent business from that of the enterprise, seeking its economic survivability and realization of profit[289].

Based on the above test, it is possible to shape the independent agent status to its proper relevance under article 5 (5) and (6) 2014 OECDMC, since, as we have seen, being independent is not self-standing. The DAPE qualification may only be eluded where the independent agent acts in the customary course of its activity.

The ordinary course test functions as a limit to the overarching qualification as independent agent from the independence test, it is necessary to refrain such qualification to the actual situation under analysis and place the activity's performance within its context, considering all facts and circumstances.

Furthermore, where the agent does not qualify under article 5 (6) 2014 OECDMC as an independent agent vis-a-vis the relevant enterprise, then it will have to go through article 5 (5) 2014 OECDMC's examination, and potentially constitute a DAPE.

Article 5 (6) 2014 OECDMC's purpose is fundamentally to be an integral part of, and to complete and clarify, article 5 (5) 2014 OECDMC since only to through such combined analysis can one accurately grasp the full extent of the DAPE concept considering an agent's activity vis-à-vis the relevant principal.

Having concluded the analysis of this provision, it is now obvious that, despite some sporadic connections with the remainder of article 5 2014 OECDMC, article 5 (5) 2014 OECDMC (with the assistance of article 5 (6) 2014 OECDMC) is an autonomous deeming provision of the PE concept, one that, once verified and its threshold surpassed, has the same objective consequences as the physical/project PE concept.

Following our comments above, the DAPE has some links with the remainder of article 5 2014 OECDMC. One of the relevant links is with article 5 (7) 2014 OECDMC, which is a provision that extends its reach beyond the DAPE and onto the other categories of the PE concept.

[289] *Ibid*.

As we will see, article 5 (7) 2014 OECDMC functions as a general limit to immediate conclusions on the qualification as a PE based on the control of a parent company over its subsidiary. This article consecrates the independent entity analysis vis-à-vis subsidiaries, meaning that for the subsidiary to qualify as a PE of the parent (or vice-versa) all relevant tests of the applicable category of the PE concept should be met.

1.7. Article 5 (7) 2014 OECDMC

Lastly, in article 5 (7) 2014 OECDMC we find a cross-sectional provision, applicable regardless of the PE concept's category under analysis:

> "*7. The fact that a company which is a 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.*"[290]

This provision's key concern is to dissipate any doubts and avoid any misinterpretation that could arise between related persons, namely between parent companies and their subsidiaries[291].

It is inferred from the above that the ownership/control relationship present in a parent-subsidiary scenario is not by itself indicative, or deeming, of a PE[292]. This provision is a corollary of the independent legal person principle, according to which the key element is that a subsidiary is a proper legal person as opposed to a branch, which does not have an autonomous legal personality[293].

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[290] OECD – *Model Tax Convention*… 2014.
[291] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 393-394; GALLO, Giulia – *Chapter 11: Active Income of Companies* In OSTASZEWSKA, Ola; OBUOFORIBO, Belema eds. – *Roy Rohatgi on International Taxation: Volume 1: Principles*. Books IBFD. 2018. p. 17.
[292] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 393-394; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.1, 40; XAVIER, Alberto – *Direito Tributário Internacional*… p. 343; GALLO, Giulia – *Chapter 11: Active*… p. 17.
[293] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 394-395; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 40; XAVIER, Alberto – *Direito Tributário Internacional*… pp. 342-343; GALLO, Giulia – *Chapter 11: Active*… p. 17.

Furthermore, it is also clear that this provision is not limited to the perspective of the parent vis-à-vis the subsidiary, it applies the other way around as well. Although not as immediately perceived, situations may occur where a parent company constitutes a PE of its subsidiary, regardless of the category[294].

This provision applies to all persons that qualify as a "company" for purposes of the 2014 OECDMC, meaning that all corporate bodies are included.

The lack of detail and guidance on terms and elements within the 2014 OECDMC is once again evidenced in this provision, on the relevant expression "control". However, it is generally understood as the right and/or factual power of one person to, at least, substantially influence all major operational business decisions of the other[295].

Although a subsidiary does not constitute a PE of its parent by itself, or vice-versa, it does not mean that such a PE cannot be deemed to exist. In fact, if the threshold of one of the PE concepts is reached, a parent or subsidiary will have a PE[296].

Considering the scope of persons affected by this article, it is common for this provision to be applied in multinational groups' cases, which could potentially give rise to complex matters. However, this provision's application remains unchanged even in a multinational group scenario, the only nuance is that the relative position of the other persons of the group is safeguarded.

In this sense, where a subsidiary is found to have a PE in the country of its parent, there is no force of attraction or overreaching relevance of that PE vis-à-vis the other subsidiaries of that parent, they are autonomous from each other[297]. Still regarding group situations, the parent company is also not deemed to have a PE as a "management office" of its subsidiaries[298].

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[294] XAVIER, Alberto – *Direito Tributário Internacional*… p. 343
[295] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 394; GALLO, Giulia – *Chapter 11: Active*… p. 17.
[296] *Ibid*; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.1, 41; XAVIER, Alberto – *Direito Tributário Internacional*… pp. 342-343.
[297] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 41.1; GALLO, Giulia – *Chapter 11: Active*… p. 17.
[298] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… p. 395; OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 38.1, 42.

While article 5 (7) 2014 OECDMC may not appear as significant as the rest of article 5 in the context of the PE concept, its existence is still worthy of note in the sense that it brightens the approach to be taken in parent-subsidiary situations, which are evermore a part of the economic fabric of global business relationships and trade.

Article 5 (7) 2014 OECDMC also plays a role in sharpening the scope of the PE concept, in the sense that it will not be bluntly applied in parent-subsidiaries scenarios, an examination should be conducted to assess if the threshold is surpassed.

This provision might nurture cross-border ventures through different settings as opposed to what could happen if such a provision did not exist, one can never overstate the importance of legal and tax certainty.

We have revealed the workings of the 2014 OECDMC's PE concept in the preceding sections through a detailed explanation of article 5, we addressed the relevant PE categories for this thesis together with the provisions that shape each category. We provided guidance, and established the basis of our understanding, in a way that provides the necessary tools to reach a decision in potential PE situations and that allows to potentially identify the shortcomings and avoidance opportunities that arise from this concept, which are the core element of this thesis.

Based on the above, it is possible to grasp the relevance and magnitude of the PE concept in international taxation. However, as we will explain there was a considerable margin of improvement within this concept, as it was identified in Action 7 and undertaken by the MLI and the 2017 OECDMC update.

1.8. Preliminary conclusions

Having concluded our explanation of article 5 2014 OECDMC, some conclusions can be drawn, be them regarding the concept's achievements or flaws.

Primarily, it is important to remember the essence and purpose of the PE concept. This concept has peacefully existed within international taxation for over a century, which can only be accomplished through its sheer relevance and a high

level of consensus and certainty from the international community around the PE concept.

The PE concept's purpose is to bestow taxing rights on the Source Country over business profits of non-resident persons, thus tipping the scales of the residence/source taxation. The Source Country should be entitled to taxing rights where a non-resident person has a sufficiently relevant presence in that territory.

Article 5 OECDMC incorporates the requirements to gauge that significant presence in the Source Country. These requirements were showcased in the preceding sections by reference to each number of article 5 2014 OECDMC, some more straightforward than others and some with less consensus than others.

The combination of the presented requirements establishes the minimum threshold that needs to be overcome for a cross-border endeavour to constitute a PE of the relevant person in the Source Country, and it does so by reference to the different ways such person may be performing its activities in the Source Country.

From our explanation above it is clear that there is a strong focus of article 5 2014 OECDMC on the physical presence of the non-resident person in the Source Country for it to be deemed to have a PE therein, be it directly, through the physical or project PE, or indirectly, through the DAPE.

Beyond the focus on the physical presence of the foreign person within the Source Country, it is also noticeable that a simple physical presence therein will not suffice, it needs to be a qualified physical presence. However, this qualified physical presence has not been kept up to speed with the economic developments on the way business was being conducted by 2014, as it is demonstrated by the interpretation, and the consequences thereof, of article 5 (4) 2014 OECDMC[299].

At the end of this Chapter, we have established the minimum threshold for a person's activity to be deemed to constitute a PE in another country, under the PE concept's version of the 2014 OECDMC.

From the PE concept's perspective, it matters to clarify that the category under which the PE status is reached is irrelevant regarding the legal consequences arising

[299] The PE concept's focus on physical presence also gives rise to considerable issues regarding its eventual application in the modern digital/dematerialized economy. Regardless, such issues are outside this thesis's scope, despite some incidental remarks.

from it, namely in relation to the other articles of the 2014 OECDMC. Nonetheless, it is natural that differences may occur by reference to the allocation of profits to each PE considering the effective activities/roles and the applicable rules[300].

Furthermore, at this point, it is possible to not only comprehend the PE's minimum threshold but also to identify some aspects that give rise to distortions and avoidance opportunities, which should be properly dealt with to prevent these effects.

Regarding article 5 (1) 2014 OECDMC, the current interpretation of its wording is not one that best suits the purpose of the PE concept, namely regarding the OECD's interpretation that the expressions "through" and "in" should be seen as synonyms in light of the "through which" criterion regarding the use of the place of business by the relevant person.

There is no doubt from a purely linguistic point of view that the two expressions relate to different aspects, but it may also have significant impacts on taxation, as the expression "through" would expand the scope of the physical PE concept, meaning that the foreign person could have a PE in the Source Country where its business is conducted through a qualifying place of business even if it is not "in" it, as it occurs for instance regarding activities that do not need human presence (the qualification in this cases would be more straightforward).

Considering that the limitation of the purpose of the expression "through" was conducted via the 2014 OECDMC Commentary, it is safe to assume that countries recognized such change as significant. From our point of view, the OECDMC Commentary should be amended so that full effect was given to the expression "through" as going beyond "in". "Through" should then be interpreted as integrating into itself "in", hence achieving a more complete and broader PE concept.

Another aspect that should be considered about article 5 (1) 2014 OECDMC, and throughout the rest of the article, is the inclusion of an effective timeframe for the PE threshold to be reached, similar to the project PE. Some authors, and even

[300] Essentially, article 7 2014 OECDMC. The attribution of profits to PEs is outside this thesis's scope and will not be analysed. However, we note that the rules and guidance on profit allocation were revised following Action 7, through the OECD's report on Additional Guidance on the Attribution of Profits to Permanent Establishments, and this continues to be a matter in discussion at the OECD.

countries' practice, tend to rely on *ad hoc* timeframes to consider as relevant a presence in the Source Country.

Consequently, it would be recommendable that such a timeframe is effectively adopted, providing further certainty to international taxation and cross-border ventures. Introducing such a limit would reduce the scope of the PE, disregarding short-time or frugal businesses.

Furthermore, article 5 2014 OECDMC is heavily focused on physical presence regardless of the category of PE. In a global and modern economy, this focus should be revised and updated to be able to keep pace with the economy and continue to be a valid and key element within international taxation, without losing sight of the background and nature of this concept.

A corollary of this concern lies in the much-needed revamp on article 5 (2) 2014 OECDMC and its list of physical PE's examples. Without prejudice of the relevance of the economic sectors portrayed in this list, the physical PEs of the current global economy are not reduced to those examples.

Although the list is not meant to be exhaustive, nor would it be feasible, it still is necessary to develop and introduce more current examples of physical PEs from the global economy of this century, with prejudice of the digital and dematerialised economy which stands apart.

Concerning article 5 (3) 2014 OECDMC and the project PE, a key concern from this concept lies with the relative ease with which persons can bypass its threshold via the fragmentation of their activity. Although the use of subcontractors for this purpose was addressed, the splitting of contracts through several persons remains unchallenged and has become a market practice, especially between related entities.

Moving along article 5 2014 OECDMC, we find in the Commentary to article 5 (4) an anti-abuse provision that deserves commendation for its purpose of fighting artificial avoidance of the PE concept through the aggregation of multiple preparatory or auxiliary activities executed by the same foreign person in the Source Country.

Despite this provision's well-deserved commendation, it still has a notorious shortcoming regarding its scope of application. With effect, this provision only targets the fragmentation of activities by a single person, and not of related persons

as well. This provision is a narrower predecessor of Action 7's amendments embraced in the MLI and the 2017 OECDMC update.

Still within article 5 (4) 2014 OECDMC, there is a feature that has been disregarded in the 2014 OECDMC Commentary and that should be properly dealt with and detailed. This aspect is the distinction between "preparatory" and "auxiliary" activities, which clearly do not refer to the same type of activities, since both the provision and the Commentary refer to them as alternatives, one or the other. The explanation of both concepts would go a long way in clarifying and improve the interpretation of this article.

Another shortfall in article 5 (4) 2014 OECDMC relates to our comments on article 5 (3) 2014 OECDMC, on the splitting and fragmentation of activities between multiple persons, especially when they are related. Article 5 (4) 2014 OECDMC deserves praise for the provision included in its Commentary against the artificial splitting of cohesive business operations by the same person in the Source Country, however, this provision is rendered useless against the fragmentation perpetrated by multiple persons.

As a result, under article 5 (3) and (4) 2014 OECDMC, a group of companies can circumvent the PE's threshold with relative ease and elude taxation of its business profits in the Source Country, despite significant presence.

Furthermore, and in close regard with our comments on article 5 (2) 2014 OECDMC, the specific activity exemptions of article 5 (4) 2014 OECDMC should also be revised and updated in connection with this century's global economy, as the activities that were once clearly preparatory or auxiliary have evolved and became economic sectors of their own.

In this sense, an antiquated negative catalogue allows for persons to avoid the PE status by shielding behind the notion of preparatory or auxiliary activities even though those are their core activities, even more so for the activities that fall within the first compartment of article 5 (4) 2014 OECDMC. Additionally, the absence of a clear and common position on the discussion presented on the nature of the first compartment of exemptions can give cause to divergent practices by countries and persons, which could impact the structuring of cross-border endeavours and lead to loopholes.

Besides the improvements needed on the physical and project PE concepts, there is also a substantial need to enhance the DAPE concept in article 5 (5) and (6) 2014 OECDMC.

Further to our comments, it is not acceptable for an international taxation provision as important as article 5 (5) 2014 OECDMC to have heterogeneous applications throughout the globe, depending on which legal family their legal system is based (Common or Civil) or even if, within the same family, some countries have unique approaches.

The existence of these disparate approaches on the application of this provision, namely regarding the binding concept, leads to avoidance opportunities that are well appreciated in the global economy, which in turn leads to the erosion of tax basis and revenue. A clear example of these practices is present in the proliferation of commissionaire structures in Civil Law countries, considering the difference between mandate with and without representation.

In a harmonious international taxation system, such practice cannot be permitted, a single concerted approach should be undertaken bearing in mind the goals sought by the countries.

The provision on article 5 (5) 2014 OECDMC Commentary according to which, the negotiation of all elements of a contract by an agent as per the contracting authority conveyed to it should still be deemed has exercised in the Source Country even when the contract is signed in the Residence Country, deserves praise as it targets a source of artificial avoidance of the PE concept's threshold. Still, such provision should be clearly included in the wording of the article and not hidden in the Commentary.

The same goes for article 5 (6) 2014 OECDMC, even though this provision is somewhat well-rounded, further guidance should be included in the Commentary to clarify the expression "their business", so that misinterpretations and different applications can be avoided in the international panorama.

By taking on and analysing article 5 2014 OECDMC, it stands clear that it is well established in the international taxation system and has been continuously updated throughout the years to keep on being an essential mechanism to allocate taxing rights to source countries.

Moreover, it is also clear that this article is far from perfect and needs to be improved so that it may maintain its role as a key figure in international taxation in an ever-changing economic reality. Furthermore, it is notorious that throughout this article there is a considerable lack of guidance and explanation of its concepts, its tests and criteria, which leads to heterogeneous practices, being this one of the consensual criticisms made on article 5 2014 OECDMC.

With this, we have concluded our exposition of the legal figure that characterizes the taxable presence of a non-resident person in a Source Country and allocates to this country the respective taxing rights over the relevant business profits of that person, *i.e.* the PE concept, based on its outline under the 2014 OECDMC.

As mentioned, this Chapter serves as the foundation for this thesis, in the same manner, that article 5 2014 OECDMC served as the foundation for Action 7, the MLI and all subsequent improvements to the PE concept. From this standpoint, one can better grasp the discussions held and the changes proposed/implemented.

CHAPTER 2: THE PERMANENT ESTABLISHMENT CONCEPT AND THE BEPS PROJECT – Action 7

In this Chapter, we will be building upon the foundation laid down by the preceding Chapter. Truly, one's perspective over the magnitude of the BEPS Project's Action 7 is clearer and broader by standing on a vantage point, in this case, it is our discussion and comments on the 2014 OECDMC's PE concept.

Our comments herein will become the nucleus of this thesis, the one point in relation to which everything else gravitates around and is connected with, just like the MLI and the 2017 OECDMC update gravitate around and are related with Action 7.

Action 7 is the epicentre of the changes to the PE concept as we know it today, the first substantive surge for effective amendments to this concept originated therein. Action 7 did not halt the adjustments to this concept, in fact, they are still happening, and their origin can be easily traced back to Action 7.

Therefore, and bearing in mind the focus of this thesis, it is paramount to address Action 7, explaining with the required detail its origin, objectives, targets, proposed solutions, and outcome. Through this Chapter one can better understand the aftershocks that followed Action 7 and the current PE concept.

With effect, the BEPS Project brought about a new standard to international taxation, and to what concerns our work, Action 7 is the new international taxation's standard on the PE concept[301]. This new standard comes from a much-needed update to an ageing concept that needed to be brought up to speed with current business models and the global economy[302].

As it is well known, Action 7 did not simply sprout, it stems from the holistic work of the BEPS Project. This undertaking was and continues to be, a fundamental

[301] PANAYI, Christiana HJI – *International Tax Law Following the OECD/G20 Base Erosion and Profit Shifting Project*. Bulletin for International Taxation. Volume 70, number 11 (2016) pp. 628-630; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package: Promise Kept*. Bulletin for International Taxation. Volume 70, number 4 (2016) p. 241; DOURADO, Ana Paula – *Governação Fiscal Global*… p. 47.

[302] DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 305.

endeavour on international taxation that shaped the current *status quo*, to which Action 7 is a branch[303].

2.1. BEPS Project

The BEPS Project is widely recognized as a landmark in international taxation for the work conducted and its results, being the first truly global and coordinated international taxation revision work[304]. The BEPS Project began as a joint effort by the G20 countries and the OECD to conduct extensive analysis on base erosion and profit shifting, which had been signalled as a global concern greatly affecting international taxation[305].

Following the 2008 financial crisis, many countries worldwide resorted to budgetary austerity to overcome those troubling times, such as tax increases, reductions in public services and public investment. Notwithstanding the impact those actions had on each country and the economy, they also had some influence on the appearance of a new worldwide phenomenon, tax scrutiny by society and the media.

This phenomenon started the current looming shadow of global tax morality that lingers over international business players, namely MNEs[306]. The difficult times that followed the financial crisis and the hard sacrifices society had to endure, made them question and seek answers on the distribution of the tax burden and of the efforts in overcoming the crisis[307].

Eventually, this led to the media embracing this expedition and shout it globally, bringing the tax payment phobia of some persons into the light, revealing their

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[303] PANAYI, Christiana HJI – *International Tax Law*… pp. 628-630; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… pp. 236-241; PISTONE, Pasquale – *Chapter 1: General Report* In LANG, Michael [et. al.] eds. – *Implementing Key BEPS Actions: Where Do We Stand?*. Books IBFD. 2019. pp. 2-3.

[304] PISTONE, Pasquale – *Chapter 1: General*… pp. 1-2; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 241; PANAYI, Christiana HJI – *International Tax Law*… p. 628.

[305] OECD – *Addressing Base Erosion and Profit Shifting*. OECD Publishing. Paris. 2013. pp. 5, 13-14. Available at: http://dx.doi.org/10.1787/9789264192744-en

[306] DOURADO, Ana Paula – *Direito Fiscal*. 4th edition. Coimbra: Almedina, 2019. p. 293; DOURADO, Ana Paula – *Governação Fiscal Global*… pp. 32-33, 47.

[307] DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… pp. 11-12.

schemes to reduce their overall tax bill, such as the LuxLeaks, the Panama Papers, and the MNEs cases of Starbucks, McDonald's, Apple, Amazon and others[308].

The result of this global spotlight on aggressive tax planning schemes, even if lawful, was a general distrust of society and taxpayers on countries and the international taxation system, as MNEs had been taking advantage of the existing system to reach their goals of a reduced, or nil, tax bill[309].

The above turned out to be the perfect storm that led to the G20 and the OECD's initiative to research BEPS to pinpoint its causes and how it could be properly dealt with, thus returning trust to the international taxation system and countries alike and rescue some tax fairness.

The results of such research were presented in February 2013 by the OECD with the report "*Addressing Base Erosion and Profit Shifting*"[310]. From this report it was clear that there is no single cause of BEPS concerns and practices, BEPS emerges from a multitude of events and rules, it is, in fact, the combination of domestic rules based on tax competition, the lack of international coordination in taxation, the lack of information of tax administrations and the inability to keep up with the evolving economy, that allowed BEPS[311].

Another conclusion from the report is that MNEs are mostly responsible for BEPS practices globally, taking advantage of the international taxation system on their behalf, with some of the tax planning schemes identified therein[312]. The report broadly defines BEPS as: "[…] *moving profits to where they are taxed at lower rates*

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[308] *Ibid*; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 304; PANAYI, Christiana HJI – *International Tax Law*… p. 628; OECD – *Addressing Base Erosion*… p. 13; BRAUNER, Yariv – *Treaties in the*… p. 989; DOURADO, Ana Paula – *Governação Fiscal Global*… pp. 43-44.

[309] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 236; PANAYI, Christiana HJI – *International Tax Law*… p. 628; DOURADO, Ana Paula – *Governação Fiscal Global*… pp. 25-26; DOURADO, Ana Paula – *Governação Fiscal Global*… p. 43; PIRES, Rita Calçada – *Manual de Direito*… p. 178.

[310] OECD – *Addressing Base Erosion*…

[311] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 236; OECD – *Addressing Base Erosion*… pp. 39-45, 47-51; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 304; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… p. 12; DOURADO Ana Paula – *Direito Fiscal*… pp. 319-320; DOURADO, Ana Paula – *Governação Fiscal Global*… p. 51; PIRES, Rita Calçada – *Manual de Direito*… pp. 157, 178.

[312] HÄGGLUND, Camilla Berkesten – *The Definition of...* p. 14; KAROLYI, Balazs – *The Challenges of*… p. 34; OECD – *Addressing Base Erosion*… pp. 73-80; LIEBMAN, Howard M. – *Chapter 11: Base Erosion and Profit Shifting: An Overview and a Review* In VAN THIEL, Servaas; VALENTE, Piergiorgio; RAVENTÓS-CALVO, Stella eds. – *CFE Tax Advisers Europe 60th Anniversary – Liber Amicorum*. Books IBFD. 2019. p. 1; PIRES, Rita Calçada – *Manual de Direito*… p. 178.

and expenses to where they are relieved at higher rates. Specific strategies may also be put in place to make use of existing "tax attributes" such as tax credits, loss-carry forwards […]". BEPS is a global concern and MNEs are global operators, both a consequence of the evolving global economy.

In this sense, since MNEs' practices and BEPS are a global problem, it became clear that the response to this issue also needed to be global and in a coordinated fashion amongst all stakeholders, otherwise, it would be an inglorious fight, with potential for further loopholes for MNEs to explore and take advantage of, thus reaching double non-taxation or very low effective taxation events[313].

Additionally, as the problem does not lie in a pinpointed feature, a simple patchwork revision on the international taxation system would not suffice, instead, a comprehensive and holistic approach needed to be taken to properly address BEPS concerns[314].

As such, aiming to re-establish source and residence taxation in situations where MNEs avoided their fair share through schemes, even though most were legal, the OECD designed a comprehensive action plan focused on the major concerns raised by BEPS practices and that demanded concrete actions[315].

The designed action plan is the well-known report "*Action Plan on Base Erosion and Profit Shifting*"[316] which identifies 15 Actions with specific targets that relate to BEPS practices and seeks to counter them in a comprehensive and coordinated manner between all countries to update global taxation standards and halt MNEs' aggressive schemes and stop them from minimising their taxation to a point of double-non taxation or almost zero taxation over their global profits[317]. There is no

[313] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 236; PANAYI, Christiana HJI – *International Tax Law*… pp. 628-629; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 304; BRAUNER, Yariv – *Treaties in the*… p. 991; OECD – *Addressing Base Erosion*… pp. 50-51; DOURADO, Ana Paula – *Governação Fiscal Global*… pp. 46, 54.
[314] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… pp. 236-237; OECD – *Addressing Base Erosion*… pp. 50-51; BRAUNER, Yariv – *Treaties in the*… p. 991; PIRES, Rita Calçada – *Manual de Direito*… p. 32.
[315] OECD – *Addressing Base Erosion*… pp. 51-53.
[316] OECD – *Action Plan on*…
[317] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 236; PANAYI, Christiana HJI – *International Tax Law*… p. 628; OECD – *Action Plan on*… pp. 7-11; MACHADO, Jónatas E. M.; COSTA, Paulo Nogueira da – *Manual de Direito…* pp. 171-172.

doubt that those MNEs practices damage all players globally, and this report, makes it clear[318].

In this report, the OECD reinforces the notion that the international taxation system is in its essence still operational, with the common consensus-based standards in force able to prevent some malicious tax practices and correctly allocate taxing rights, yet an update is overdue and the system needs to be brought to the XXI century, which requires a unique approach from all countries and the OECD in closing loopholes, gaps and mismatches that allow BEPS practices and MNEs' no, or low, taxation[319].

These MNEs' BEPS practices place the international taxation system under stress, as such, it is necessary to address them, return some peace to the international taxation system and bring taxation to where it is due[320]. To accomplish such a goal, fundamental changes to the system are needed and an unprecedented move by all countries is required[321].

In fact, this report is singular in history in the way it brought together, in the fight against BEPS practices and MNEs' tax avoidance, all G20 and OECD countries, as well as developing countries and other relevant stakeholders, as prescribed in the methodology for this work for an inclusive and effective process[322].

Even though fundamental changes were needed, the report did not call for a change in the existing international standards, instead, it sought to introduce new complementary standards and operate within the existing consensus-based standards, optimizing the current rules and introducing new approaches that were also based on a consensus, thus realigning taxation and substance[323].

It is undeniable that the existing international taxation system was successful in dealing with double taxation and still is, however, the existing system was not adequately equipped to combat double non-taxation or avoidance schemes based on the interaction of multiples countries' tax rules, also double non-taxation had not

[318] OECD – *Action Plan on*… p. 8.
[319] OECD – *Action Plan on*… pp. 9-11.
[320] OECD – *Action Plan on*… pp. 10-11.
[321] OECD – *Action Plan on*… pp. 13-14.
[322] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 236; PANAYI, Christiana HJI – *International Tax Law*… pp. 628-629; OECD – *Action Plan on*… pp. 25-26; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… p. 13.
[323] OECD – *Action Plan on*… pp. 11-13; PANAYI, Christiana HJI – *International Tax Law*… p. 629.

been a major concern in the global panorama to justify granting the OECD a mandate in that regard.

Since the world's economy and technology evolved, but the international taxation system did not keep pace, MNEs took advantage of its shortcomings, proving again that the OECD and the reforms of the OECDMC are not pre-emptive vis-à-vis taxpayers' actions but instead follows their actions from behind trying to patch the holes carved by such actions[324].

Therefore, the international taxation system was in dire need of these 15 Actions to cut the distance between MNEs' practices and the existing system or even to surpass and prevent some MNEs' practices. These 15 Actions stand on top of three fundamental pillars: coherence, substance, and transparency[325].

Considering these pillars, the OECD identified that the PE concept is a key BEPS concern and that it had been subject to abusive practices, with MNEs taking advantage of the existing rules on this concept to evade having a PE in the Source Country, as that would lead to a potential increase in their tax burden, reason why the report has an action dedicated to the BEPS issues related with the PE concept and that changes to the OECDMC were needed[326].

Additionally, bearing in mind the concerns over a swift and comprehensive implementation of the amendments to be proposed, the OECD also presented a rare solution for this purpose, a multilateral instrument that would be able to implement such amendments to all existing DTTs without the need to revise each one individually, especially considering the sheer number of DTTs in force[327].

This report was the starting key to the OECD's work over the next two years, to develop strategies and solutions for each of the 15 actions, and more importantly to reach an outcome that was based on an extended consensus between all parties involved, otherwise, its success could, and would, be questioned[328].

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[324] PIRES, Rita Calçada – *Manual de Direito*… pp. 19-20, 32.
[325] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 236; OECD – *Action Plan on*… pp. 15-24; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… p. 13.
[326] OECD – *Action Plan on*… pp. 19-20.
[327] OECD – *Action Plan on*… pp. 23-24; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 240; PANAYI, Christiana HJI – *International Tax Law*… pp. 645-646.
[328] OECD – *Action Plan on*… pp. 24-26; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… pp. 236-237; PANAYI, Christiana HJI – *International Tax Law*… p. 629.

From mid-2013 to 2015, the OECD worked relentlessly on all 15 actions, having presented interim discussion drafts and collected relevant input from interested parties, and reaching a joint conclusion of all 15 actions in 2015, when the notable BEPS Project Final Reports were issued and the international taxation system shook before the proposed amendments[329].

With effect, in 2015, the OECD released the bulk of those 15 actions' final reports, concluding their initial endeavour to develop strategies and solutions for the issues identified in the 2013 reports, and introducing proposals for substantial reforms in those areas[330].

The outcome of the BEPS Project's Final Reports presented three great groups of deliverables. The first group relates to minimum standards, which were agreed upon by all parties and, similarly to soft law provisions, should be implemented by countries; the second group is comprised of reinforced standards, about which a consensus was not fully achieved to become minimum standards (such as on Action 7); and finally, the third group, which includes best practices and common approaches[331].

Although the BEPS Project initially sought to achieve a holistic approach and solutions to the international taxation system, it soon embraced more realistic objectives for the sake of consensus-based results, the solution was a pragmatic approach on the issues identified and the solutions offered[332].

Still, the pragmatic approach taken cannot be ruled as unsuccessful. The outcome of the final reports effectively addresses BEPS concerns and the issues identified in the 2013 reports, and places stronger barriers in double non-taxation and low tax schemes, even though a more ambitious outcome with stronger measures and results, without significant spillover, was expected[333].

Yet, perhaps the importance and relevance of the BEPS Project are not in the solutions proposed, since they often originate from previous work conducted by the

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[329] PANAYI, Christiana HJI – *International Tax Law*… p. 629.
[330] *Ibid*; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 237.
[331] PANAYI, Christiana HJI – *International Tax Law*… p. 630; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 237; PISTONE, Pasquale – *Chapter 1: General*… pp. 1-2.
[332] DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 311; PANAYI, Christiana HJI – *International Tax Law*… p. 628.
[333] PANAYI, Christiana HJI – *International Tax Law*… p. 660; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 241; KAROLYI, Balazs – *The Challenges of*… pp. 34-35.

OECD, but in the way these solutions were enhanced and proposed, as the first global coordinated and inclusive endeavour to reform the international taxation system, even though it has not been a profound renovation[334].

Additionally, it bears to mention that the BEPS Project is not a one-off event that completed its purpose with the release of the 2015 15 Actions' Final Reports. The BEPS Project is a continuous program that seeks to restore harmony to the international taxation system by ending MNEs' avoidance practices and returning taxation to source and residence, where it has been lacking.

As important as presenting 15 courses of action to fight against MNEs' avoidance practices is their implementation and monitoring, which is the current purpose and objective of the BEPS Project, the implementation and monitoring of the agreed-upon anti-BEPS measures through the OECD/G20 Inclusive Framework on BEPS, especially of the minimum standards[335].

It is clear the context from where Action 7 emerges and what should be expected from its content, especially considering it is included in the pillar on reinforcing substance requirements and that the avoidance of the PE status by MNEs was a BEPS practice identified since the BEPS Project's inception. Following our brief remarks on the BEPS Project, we will dedicate the following sections to Action 7 and the proposed amendments to the PE concept.

We will be focusing on MNEs' BEPS practices related with the artificial avoidance of the PE status, which is directly connected with its concept, and the corresponding course of action by Action 7. Furthermore, as per the OECD's findings, MNEs are the leading cause of BEPS practices, hence our analysis throughout this work will be made based on MNEs' perspective.

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[334] PANAYI, Christiana HJI – *International Tax Law*… p. 628; GONZÁLEZ-BARREDA, Pablo A. Hernández – *A Historical Analysis of the BEPS Action Plan: Old Acquaintances, New Friends and the Need for a New Approach*. Intertax. Volume 46, issue 4 (2018) pp. 278-289.

[335] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 241; PANAYI, Christiana HJI – *International Tax Law*… p. 630.

2.2. Action 7

The strenuous analysis conducted by the OECD on BEPS practices revealed that in the current global economy and business reality, MNEs were actively and aggressively taking advantage of gaps and mismatches in the existing international taxation system, which brought them interesting tax advantages, reaching double non-taxation events or very low taxation.

MNEs' BEPS practices can be broadly defined as specific strategies that seek to shift profits from high-tax countries to those with little to no taxation, thus eroding the tax base in high-tax countries. These strategies are put in place at a global level, meaning that no single country can effectively fight against such practices, hence the need for the inclusive and coordinated work of the BEPS Project.

BEPS practices explore the international taxation system's loopholes and mismatches, therefore DTTs are of particular importance for these practices, reason why the BEPS Project also focused on DTTs' measures to prevent these practices[336][337].

2.2.1. Pre-Action 7 Final Report

Within DTTs, the PE status is a constant concern for MNEs when conducting cross-border business activities, since it seeks to allocate taxing rights to a foreign country where a person is actively engaged in the course of its business, the Source Country. As mentioned, for the Source Country to be entitled to such taxing rights, the PE concept threshold must be surmounted.

In this sense, the OECD's 2013 analysis revealed that one of the MNEs' BEPS practices was the artificial avoidance of the PE status in countries where it was actively engaged in the course of their business, thus eluding taxation in the Source Country and reducing their overall tax burden[338].

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[336] OECD – *Action Plan on*… pp. 13, 18-19; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… pp. 304-305; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 238; DOURADO, Ana Paula – *Direito Fiscal*… pp. 295-296.
[337] This is particularly the case of the BEPS Project's Action 6 and Action 7.
[338] OECD – *Action Plan on*… p. 19.

Specifically, the OECD found that MNEs actively explored BEPS opportunities by changing local subsidiaries from distributors to commissionaire arrangements, mainly in countries where commissionaire agents do not give rise to a DAPE therein, and by artificially fragmenting their activities among several group entities, so that each activity could be seen as preparatory or auxiliary and the PE status prevented[339].

The common point on these BEPS practices is the artificiality with which MNEs evade the PE status and shift their profits from high-tax source countries to low, to no, taxation countries, even though there is an active and substantial business activity therein[340]. Artificiality is a core focus within Action 7 and the amendments proposed to the PE concept.

In this sense, the OECD found that changes to the PE concept were needed to prevent the artificial avoidance of the PE status[341]. From this basis, the OECD began its work on drafting proposals to amend the PE concept, which would eventually lead to Action 7's Final Report.

During its two-year labour, the OECD published two discussion drafts on the BEPS issues regarding the artificial avoidance of the PE concept, the first in October 2014 and the second in May 2015, and collected valuable input from countries and practitioners on the BEPS concerns related with the PE concept and its proposed amendments.

These two discussion drafts elaborated further on the concerns over the PE concept's artificial avoidance and presented several alternatives to amend this concept considering the typical situations identified[342]. The focus of both discussion drafts and Action 7, is article 5 (3) to (6) OECDMC and the related Commentary.

We will only focus on the final approved guidance to amend the PE concept that kick-started this concept's revamping.

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339 *Ibid*.
340 DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… pp. 305-306; KAROLYI, Balazs – *The Challenges of*… p. 34.
341 OECD – *Action Plan on*… p. 19.
342 DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 306; PANAYI, Christiana HJI – *International Tax Law*… pp. 640-641; CUNNINGHAM, Kevin – *The Post-BEPS World*… pp. 503-504; PANAYI, Christiana HJI – *The Compatibility of the OECD/G20 Base Erosion and Profit Shifting Proposals with EU Law*. Bulletin for International Taxation. Volume 70, number 1/2 (2016) p. 96.

2.2.2. Action 7 Final Report

The combined efforts of all interested parties in the artificial avoidance of the PE status gave rise to a set of consensus-based amendments to the PE concept and, in October 2015, the Final Report on Action 7 "*Preventing the Artificial Avoidance of Permanent Establishment Status*"[343] was published, and later supported and approved by the G20.

From its inception, Action 7 became the new international standard on the PE concept, bringing the first sizeable renovation to this concept and the international taxation system in over a century, especially since the PE concept has remained almost unchanged for *circa* 50 years[344].

Considering the lack of substantial change for some decades and the continuing evolution of technology and the economy, MNEs had the time and the will to understand the existing shortcomings and loopholes in the PE concept and put them to use on their behalf[345]. The drive of MNEs involved in BEPS practices is essentially to conduct their business activities maximizing their profit and minimizing their tax burden.

Since the PE concept functions as a threshold over which the Source Country has the right to tax a person's business profits related to the business activity exercised in said country, MNEs' aim rested in designing strategies that would allow them to continue their business without breaching such threshold, thus preventing the PE status and source taxation, meaning an artificial avoidance of the PE concept[346].

These strategies prove that the PE concept of article 5 2014 OECDMC is susceptible to avoidance and to the shifting of profits from where the activities are conducted and value is created, and MNEs can fairly easily circumvent this status[347]. Also, the PE concept had failed to accompany technological leaps in the economy

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[343] OECD – *Preventing the Artificial*…
[344] OECD – *Preventing the Artificial*… p. 3; PANAYI, Christiana HJI – *International Tax Law*… pp. 640-641; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 503.
[345] WETTERSTEN, Maria – *How can the*… p. 10; GILLESPIE, John – *The Base Erosion*… pp. 21-22; DOURADO, Ana Paula – *Governação Fiscal Global*… pp. 84-85.
[346] OECD – *Preventing the Artificial*… p. 9.
[347] PANAYI, Christiana HJI – *International Tax Law*… pp. 640-641.

and to be an effective weapon against double non-taxation and aggressive tax avoidance, in fact, it was a leading cause of these disruptive problems[348].

In this sense, Action 7's objective was to upgrade the PE concept to nullify the identified BEPS strategies seeking the artificial avoidance of PE status and return taxation to where activities are carried out and value is created, which was not occurring, thus equilibrating source and residence taxation[349].

Following on the initial work of the 2013 BEPS Project's reports and the 2014 and 2015 discussion drafts, Action 7 presents pragmatic amendments to article 5 2014 OECDMC's PE concept[350].

From Action 7, it was clear that to address these BEPS practices a change on the existing PE concept was needed, yet such need was not extended to the international standards on top of which this concept was built, as Action 7's focus is on upgrading the existing international standards on the allocation of taxing rights based on the PE concept and DTTs, and not on changing them[351].

Furthermore, since article 5 2014 OECDMC was at the epicentre of the artificial avoidance of the PE status strategies, Action 7's proposed amendments on the wording of the article and its Commentary, as otherwise the PE concept would not be modified, especially considering the relevance in the international taxation panorama of the OECDMC as the basis for negotiating DTTs[352].

However, since Action 7 is at most soft law, the effectiveness and implementation of the proposed amendments would be left to the countries through the renegotiation of existing DTTs or new ones, without disregarding the solution brought by Action 15 (the MLI) which will be addressed in the following Chapter[353].

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348 DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 305; PANAYI, Christiana HJI – *International Tax Law*… p. 640; OECD – *Preventing the Artificial*… pp. 9, 13-14; BRAUNER, Yariv – *Treaties in the*… p. 1007.

349 SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 237; PANAYI, Christiana HJI – *International Tax Law*… pp. 640-641; OECD – *Preventing the Artificial*… pp. 9, 13-14; LANKHORST, Paul; VAN DAM, Harmen – *Post-BEPS Tax Advisory and Tax Structuring from a Tax Practitioner's View*. Erasmus Law Review. Volume 10, number 1 (2017) p. 61.

350 PANAYI, Christiana HJI – *International Tax Law*… pp. 640-641; CUNNINGHAM, Kevin – *The Post-BEPS World*… pp. 503-504; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 306; OECD – *Preventing the Artificial*… pp. 9-11, 13-14.

351 OECD – *Preventing the Artificial*… p. 14.

352 OECD – *Preventing the Artificial*… pp. 9-11, 13-14; CUNNINGHAM, Kevin – *The Post-BEPS World*… pp. 503-504

353 CUNNINGHAM, Kevin – *The Post-BEPS World*… pp. 503-504; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 306.

At this stage, regardless of implementation, it matters to converge on Action 7's amendments, which are grouped by the OECD into three main groups as per the identified causes of avoidance of the PE status through BEPS strategies: (i) commissionaire arrangements and similar strategies[354], (ii) the specific activity exemptions of article 5 (4) 2014 OECDMC[355], and (iii) other strategies such as the fragmentation of activities between related entities[356].

Within each of these three groups of recommendations, the OECD conveys the findings of its exhaustive work on MNEs' BEPS strategies for the avoidance of the PE status in the form of amendments to be included on article 5 OECDMC, based on its 2014 version. Commissionaire arrangements and similar practices, the specific activity exemptions list and the splitting-up of contracts are the common strategies put in place by MNEs to shift their profits and erode the tax basis of source countries identified by the OECD[357].

The grouping of the changes prescribed by the OECD into those three groups should not limit the perception of the amendments, as each group has within it a multitude of elements that, as a whole, constitute the PE concept's upgrade. As our analysis will reveal, each group of amendments divides itself into further changes to article 5 OECDMC regarding BEPS strategies for the artificial avoidance of the PE status.

Despite the mentioned grouping of Action 7's proposals, our analysis will not follow that organization, instead, for the sake of clarity and cross-sectional comprehension of our work, we will showcase our analysis following the proposed amendments' connection with article 5 OECDMC and in the same order as the preceding Chapter.

Without prejudice of our upcoming analysis and conclusions, there are some initial comments we can immediately relay on Action 7 based on an overview of its content, which may guide our analysis.

[354] OECD – *Preventing the Artificial*… pp. 15-27.
[355] OECD – *Preventing the Artificial*… pp. 28-41.
[356] OECD – *Preventing the Artificial*… pp. 42-44.
[357] OECD – *Preventing the Artificial*… pp. 9-11.

Based on the BEPS strategies put in place by MNEs identified in Action 7, clearly MNEs have been operating globally beneath the radar of the PE concept and eluding this status.

Therefore, it is clear that the amendments sought by the OECD in Action 7 target the PE status' threshold and the goal is to lower it, thus widening the net of the PE concept to catch MNEs that used to elude it.

To accomplish a lower threshold, the OECD took a route of expanding the PE concept to absorb situations that were not previously foreseen in article 5 2014 OECDMC, and/or others in relation to which there was a divergent understanding between countries as to whether such situations were foreseen within it or not, and also limiting MNEs' ability to take refuge in the exempted activities[358].

As in any situation, there are two sides to it, and while the modifications to lower the PE threshold to prevent BEPS practices by MNEs that artificially avoid PE status are commendable and should be implemented, it is also necessary to provide proper and sufficient guidance on those very same modifications to prevent legal uncertainty, which is a key issue on cross-border business and the global economy.

At the same time, it is important to consider the full extent of the modifications proposed and potential spillover effects, such as abusive actions by domestic tax administrations that are receiving high-impact ammunition to fire them in all directions, overbearing compliance costs for MNEs (and other persons) due to a lower PE threshold, and the unintended effect on smaller or sporadic cross-border ventures that could get caught in the wider net of the PE concept. These, and other, concerns, will be addressed in the following sections.

Following our introductory remarks on Action 7, we will dive into its depths, beginning with a detailed analysis of the BEPS strategies identified therein that lead to the artificial avoidance of PE status and moving onto the proposed amendments to this concept.

[358] PANAYI, Christiana HJI – *International Tax Law*… p. 641; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 306. CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 503.

2.3. Artificial avoidance of PE status – causes and practices vs amendments and solutions

Ever since the BEPS Project's 2013 Action Plan report, the key concern regarding BEPS practices in the field of the artificial avoidance of the PE status are mainly focused on commissionaire arrangements and similar strategies, and on the specific activity exemptions of article 5 (4) 2014 OECDMC.

With the Final Report on Action 7, and considering the contributions received from the discussion drafts, the OECD matured its initial thoughts on the strategies that lead to artificial avoidance of PE status and solidified them onto three problematic groups of avoidance strategies often used by MNEs in the BEPS context, (i) commissionaire arrangements and similar strategies, (ii) specific activity exemptions, and (iii) other artificial avoidance strategies[359]. Each group of strategies then divides itself into concrete BEPS strategies put in place by MNEs to artificially avoid PE status.

Action 7 recommends a considerable set of amendments to the OECDMC and its Commentary that targets each of the abovementioned groups of BEPS strategies so that those strategies are rendered ineffective and taxation may return to where it has, and should not have been, lacking[360].

Before our analysis and explanation of the amendments proposed in Action 7, we will first reveal and analyse the BEPS strategies that were considered noxious to the international taxation system and the PE concept, by exposing their mechanics and damaging effect.

Some of the BEPS strategies identified in Action 7 arise from vulnerabilities already identified by the OECD within article 5 OECDMC, however, it had failed to properly correct them in past reviews, so MNEs simply exploited said vulnerabilities and reaped tainted benefits[361].

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[359] OECD – *Preventing the Artificial*… pp. 9-11.
[360] *Ibid*.
[361] For instance, the issues connected with the DAPE discussion and the interpretation of "binding" upon the principal or the concerns over the splitting-up of contracts under the project PE addressed in the 2014 OECDMC Commentary.

Naturally, some of the BEPS strategies referred to in Action 7 are not a novelty, in fact, we have already addressed some of these strategies in our preliminary conclusions in Chapter 1, where we mentioned the problems, shortcomings, and flaws of article 5 2014 OECDMC. Although not all issues commented therein were included in Action 7, some were and their cause will be clear, as will their effects.

In this sense, we will advance onto our analysis of each of the BEPS' causes and practices that served as the basis for Action 7's proposed amendments to article 5 OECDMC as per the abovementioned method and structure.

2.3.1. Article 5 (3) 2014 OECDMC – project PE and splitting-up of contracts

The first BEPS' cause and practice that MNEs have been found to commonly execute and that we will address relates to the project PE of article 5 (3) 2014 OECDMC, hence mostly focused on the construction, exploration and exploitation of natural resources and other similar sectors.

This first strategy is focused on the project PE and is closely connected with the fragmentation and anti-abuse issues commented on in Chapter 1. Following the OECD/G20's work, MNEs were found to being actively and artificially splitting-up contracts to avoid PE status in the Source Country.

We will present the causes and practices related with this strategy to adequately explain and analyse the amendments and solutions proposed in Action 7 to prevent such practices and eliminate their cause.

2.3.1.1. Causes and practices

Following our comments in section 1.3 on article 5 (3) 2014 OECDMC's project PE, it is clear that where a person is engaged in qualifying business activities in the Source Country, in a site or project and that it exceeds the 12-month test, said person will be deemed to have a project PE therein, thus taxes will likely be due in that country.

We also made clear that even though the physical presence nexus is vital, and to some extent, the tests of the physical PE still need to be accomplished, the 12-month

test is instrumental to the project PE, meaning that where it is not reached, neither is the project PE's threshold and the relevant person will not have PE status in the Source Country. Also, the time computation for the 12-month test is made per site or project and per contractor executing a business activity within it.

Setting clear and objective limits, as the 12-month test, tends to be prone to abuse and circumvention, especially with avoiding taxation as an incentive[362]. Nonetheless, the usefulness and validity of such limits are undeniable, particularly in the PE concept, which is not intended to encapsulate all business activities but only those that are relevant and material enough to give rise to such status.

Therefore, MNEs engaged in qualifying business activities within a site or project in a country, such as in the construction or exploration/exploitation of natural resources sectors, and that wish to avoid taxation in that country, have found that their focus should be on the 12-month test and on how to remain beneath it[363].

The initial strategy to circumvent the 12-month test and avoid the PE status is found in the relation between the general contractor and the subcontractors, as pointed out in the previous Chapter. This has been detected and eradicated by the OECD, as per article 5 (3) 2014 OECDMC Commentary, by stating that the time spent by each subcontractor is aggregated in the computation of the time spent by the contractor in that site or project for the 12-month test[364].

Since the above strategy was identified and properly dealt with by the OECD, the relevant persons, and specifically MNEs, needed to seek out a different strategy that could lead to the same result, not reaching the 12-month threshold and avoiding PE status.

Further to our comments about the existing flaws of article 5 (3) 2014 OECDMC, the OECD failed to tackle the fragmentation of site or project activities between group enterprises within the project PE.

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362 BETTEN, Rijkele; NAOUM, Monia – *Chapter 2: Permanent Establishments in International Tax Structuring* In COTRUT, Madalina [et. al.] eds. – *International Tax Structures in the BEPS Era: An Analysis of Anti-Abuse Measures*. Books IBFD. 2015. p. 2.

363 OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 18; OECD – *Preventing the Artificial*… pp. 42-44; KAROLYI, Balazs – *The Challenges of*… p. 47; ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… p. 25.

364 OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 19; BETTEN, Rijkele; NAOUM, Monia – *Chapter 2: Permanent…* p. 2.

Since the division of the execution of contracts through multiple subcontractors under a single general contractor was no longer a viable option for MNEs to avoid PE status, MNEs applied the same principle to the contracts themselves and the new strategy sought to divide the contracts amongst multiple related enterprises, in such a way that each entity (and contract) remained under the 12-month test[365].

In this sense, MNEs seeking to carry out activities within a site or project that would last more than 12 months, such as the construction of a power plant, dredging of a riverbed, exploitation of resources in the continental shelf and others alike; before commencement, would divide traditionally whole contracts for such works into multiple shorter contracts between themselves and multiple group enterprises[366].

The MNEs' tax structuring strategy to artificially fragment contracts allows each of the group enterprises to not have a significant taxable presence in the Source Country, as they do not reach the 12-month test nor the PE status, on the account of an abusive stance on article 5 (3) 2014 OECDMC, hence avoiding source taxation[367].

To put it into an evocative example, consider a site for the construction of a building in country B which should be completed within 24 months. Company 1, resident in country A, won the procedure for this build and will directly engage the client. Company 1 expects the construction to last 20 months, which would mean that it would reach PE status in country B if it concluded a single contract with the client.

Instead, since Company 1 is a company of Construction Group, the contract with the client will be divided into three shorter contracts, each with a different company related to Company 1 and residents in country A. Company 1 will engage the client for a portion of the work, expected to last 8 months, such as the construction and engineering works; Company 2 engages the client for work that is expected to last 5 months, which could be the installation of equipment in the building and testing the

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[365] BETTEN, Rijkele; NAOUM, Monia – *Chapter 2: Permanent…* p. 2; KAROLYI, Balazs – *The Challenges of*… p. 47; ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… p. 25; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509; DE WILDE, Maarten Floris – *Lowering the Permanent Establishment Threshold via the Anti-BEPS Convention: Much Ado About Nothing?*. Intertax. Volume 45, issue 8/9 (2017) p. 561.

[366] *Ibid*.

[367] DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 561; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 309.

structure; and Company 3's contractual work is expected to last 7 months, for instance, interior design and final construction works.

Following the above, through artificially splitting-up the building construction's contract, companies 1, 2 and 3 would be able to avoid PE status in country B and elude source taxation by abusively taking advantage of the 12-month test of article 5 (3) 2014 OECDMC, hence all three companies would only be liable to taxation in country A[368]. This also means that the Construction Group's overall taxation would be lower, a common concern and objective for MNEs.

Moreover, an additional advantage of this tax planning strategy may arise regarding the employment income of the workers from country A engaged in such work[369][370].

This MNEs' BEPS practice meant that what was once a complete and whole contract, and the common practice in the project PE's realm, is now an artificial puzzle with as many pieces as needed to avoid PE status and reduce taxation.

Surprisingly, the OECD identified such practice in the Commentary by reference to works on the continental shelf or the exploration and exploitation of the continental shelf, yet no effective action was taken to eradicate this strategy by addressing its cause[371]. Perhaps, at least until Action 7[372].

As demonstrated, the cause for this BEPS practice does not lie with the 12-month test itself, which has been proven effective and welcomed by countries, although some introduce variations in the duration.

In fact, the cause for this practice is the lack of action by the OECD on an already identified problem, and more so, when it already knew a potentially effective method to counter this practice, the same as the one used against the fragmentation between contractors and subcontractors.

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[368] *Ibid*; BETTEN, Rijkele; NAOUM, Monia – *Chapter 2: Permanent…* pp. 2-3; ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… p. 25; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509.
[369] Pursuant to article 15 (2) OECDMC.
[370] BETTEN, Rijkele; NAOUM, Monia – *Chapter 2: Permanent…* p. 3.
[371] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 18; OECD – *Preventing the Artificial*… p. 42.
[372] OECD – *Preventing the Artificial*… pp. 43-44.

We will now address and explain Action 7's suggested method to prevent the above causes and BEPS' practices, which is also connected with the second BEPS strategy identified in Action 7.

2.3.1.2. Amendments and solutions

Further to the explanation on the causes and practices, the OECD had already this BEPS' strategy well identified, however, the OECD considered it unnecessary to take action against it, instead relied on the ability of each country to combat said practice through domestic anti-abuse rules or on *ad hoc* provisions introduced by countries on DTTs.

Considering the outcome, the initial OECD policy failed, and direct action needed to take place against these BEPS strategies. The OECD intends to take this direct action on more than one front within the BEPS Project, if at first, the OECD missed, now they might be coming for an overkill[373].

In this sense, the OECD aims at eliminating these splitting-up of contracts' strategies through two solutions, the first is the solution proposed under Action 6[374], in particular with the principle purpose test anti-abuse provision that should be implemented in DTTs and that denies DTTs' benefits if a principal purpose of a strategy is to obtain a DTT benefit (beyond the object and purpose of the DTT provision)[375], and the second, and more relevant to this thesis, is an automatic provision specifically designed to prevent the splitting-up of contracts in the context of article 5 (3) OECDMC[376].

Our explanation and analysis will be centred on the specific solution to the causes and practices addressed above, which is to be used where DTTs do not have the principal purpose test anti-abuse provision, or as an alternative to this rule for countries specifically targeting these practices[377].

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[373] OECD – *Preventing the Artificial*… p. 42.
[374] OECD – *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report*. OECD/G20 Base Erosion and Profit Shifting Project. OECD Publishing. Paris, 2015. Available at: http://dx.doi.org/10.1787/9789264241695-en
[375] OECD – *Preventing the Artificial*… p. 42; OECD – *Preventing the Granting*… p. 9.
[376] OECD – *Preventing the Artificial*… pp. 42-44.
[377] OECD – *Preventing the Artificial*… p. 42.

Also, this solution is unique within Action 7, since it is exclusively focused on the Commentary to article 5 (3) OECDMC, whilst all other amendments and solutions focus on both the wording and the Commentary of article 5's relevant provision.

Although singular within Action 7, this solution is connected with some of the other proposed modifications to article 5 2014 OECDMC, namely with that of the second feature of the second BEPS strategy, similar to a draft to the finished thesis, which will be addressed further along.

As commented, the OECD had already taken measures against a similar abusive strategy, regarding general contractors and subcontractors. The anti-abuse solution implemented by the OECD, also only in the Commentary, stated that the time spent by the subcontractors would be included in the computation of the contractor's time for the 12-month test, hence removing any incentive to divide the work required[378].

The OECD must have kept the blueprints of that anti-abuse measure, as the solution proposed under Acton 7 may be seen as an improved rendition of that measure.

As ascertained, the BEPS strategy to artificially avoid project PE status relies on the ability to fragment a traditionally whole contract into several contracts, each with a group enterprise, in a way that each related enterprise stays under the 12-month threshold and the PE status.

In this sense, the solution proposed under Action 7 to prevent this splitting practice goes in line with the one abovementioned for the contractor/subcontractor practice, by putting forward a suggestion of a time aggregator provision for related enterprises in the Commentary, which countries may use when drafting individual DTTs[379].

With effect, Action 7's anti-splitting specific anti-abuse provision foresees that when assessing the 12-month test in relation to a foreign enterprise engaged in qualifying activities at a building site/project in the Source Country that lasts less than 12 months, the time spent by other, closely related, enterprises that carry on connected activities for over 30 days at that same site/project during different

[378] OECD – *Model Tax Convention*… 2014. Commentary on article 5 para. 19.
[379] OECD – *Preventing the Artificial*… p. 43; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 562.

periods of time, shall be added to the time spent by the first-mentioned foreign enterprise[380].

The underlying logic is the same as in the contractor/subcontractor provision, where the foreign enterprise is the contractor and the closely related enterprises are the subcontractors, however, differently from the contractor/subcontractor provision, the closely related enterprises also fall within this provision, since the aggregated computation applies to all involved parties[381].

By aggregating the time spent by the relevant enterprise and the other closely related enterprises, this proposed specific anti-abuse provision would effectively become an anti-splitting provision by removing the effects of splitting contracts between those enterprises, hence preventing the artificial avoidance of project PE status[382].

Notwithstanding, some key elements in this recommended solution must be verified before its application, as they are new concepts within the OECDMC, the "closely related" and the "connected activities" concepts.

The "closely related" concept is part of a proposed solution under Action 7 for the artificial avoidance of PE status and plays a significant role throughout Action 7 as a supportive concept for several of the specific solutions, more importantly in the independent agent concept. In this sense, Action 7 recommends the addition of this concept as a new paragraph to article 5 (6) OECDMC[383]. Considering this concept's relevance in the context of the independent agent concept, we will address it in a specific subsection.

On the matter of the new "connected activities" concept, Action 7 provides guidance within the Commentary to assist in its interpretation, adding to the existing guidance on article 5 (3) OECDMC. On this note, the proposed Commentary refers that the determination of whether activities are connected should be done by considering the facts and circumstances of each situation[384].

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[380] OECD – *Preventing the Artificial*… p. 43; MEHTA, Amar – *Chapter 4: The New Law on Permanent Establishment in the Digital Economy (as of October 2018)* In WHEELER, Joanna ed. – *The Aftermath of BEPS*. Books IBFD. 2020. p. 6; KAROLYI, Balazs – *The Challenges of*… p. 47.
[381] *Ibid*; ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… p. 26.
[382] BETTEN, Rijkele; NAOUM, Monia – *Chapter 2: Permanent…* p. 13.
[383] OECD – *Preventing the Artificial*… pp. 16-17, 43.
[384] OECD – *Preventing the Artificial*… pp. 43-44.

Furthermore, the proposed Commentary identifies some relevant elements for this analysis and that provide a clearer path in the subjectivity brought about by a facts and circumstances' approach. These elements can be grouped as follows[385]:

i. Persons – whether the same person or related persons entered into the contracts covering the different activities;
ii. Connection – whether the subsequent contracts are a logical consequence of the previous contract with the same person or a related person;
iii. Purpose – whether the connected activities would be covered by a single contract, absent tax structuring considerations;
iv. Nature – whether the connected activities under the different contracts have the same, or similar, nature; and,
v. Employees – whether different employees perform the connected activities under the different contracts.

Following the above, it is clear that Action 7's proposed amendments to the Commentary on article 5 (3) OECDMC would mean a new standard for the project PE and a lower threshold to reach such status.

This lower threshold would be a direct consequence of the relevance granted to the connection between the fragmented contracts for connected activities concluded by closely related enterprises for purposes of the 12-month test since the time spent by each enterprise would now be aggregated for purposes of the fulfilment by the relevant enterprise's 12-month test[386].

Action 7's recommended solution against splitting-up of contracts' practices would effectively nullify this strategy and prevent the artificial avoidance of project PE status through it. The proposed solution would mean that no longer would MNEs have an incentive to split their activities on a site/project into multiple contracts with related enterprises, as the individual time spent by each enterprise would be considered in the computation of the relevant enterprise[387].

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[385] OECD – *Preventing the Artificial*… p. 44; MEHTA, Amar – *Chapter 4: The*… p. 6; KAROLYI, Balazs – *The Challenges of*… p. 47.
[386] ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… p. 26; BETTEN, Rijkele; NAOUM, Monia – *Chapter 2: Permanent…* p. 13.
[387] BETTEN, Rijkele; NAOUM, Monia – *Chapter 2: Permanent…* p. 13.

Recalling our example above of the building construction in country B by Company 1, should Action 7's recommended course of action be implemented by both countries' DTT, it would mean that Company 1 would have a project PE in country B, as the time spent by Company 2 and 3 in country B would be added to that of Company 1, totalling 20 months, since, taking into account the elements referred to above, the activities carried out are effectively connected.

Company 1 would have a project PE in country B and would be subject to taxation therein, also, not only would Company 1 have a project PE in country B, as Company 2 and 3 would also have a project PE therein, meaning overall increased source taxation and the complete elimination of the tax advantages sought by this BEPS strategy.

This anti-splitting provision would render ineffective MNEs' tax planning schemes and render the closely related companies involved in such schemes subject to the project PE status in the Source Country, provided that the remainder of project PE's tests addressed in Chapter 1 are complied with.

2.3.1.3. Analysis

With the above, it is now clear the full extent of the solution proposed in Action 7 to prevent the splitting-up of contracts' practices identified in this first BEPS strategy, which allows the comprehension of its impacts in the international taxation system vis-à-vis the causes and practices commented.

To correctly appraise Action 7's solution against this BEPS strategy it is necessary to put it into perspective with this strategy's causes and practices. In this sense, we find this solution to be a reasonable path to the elimination of the splitting-up of contracts' practices affecting the project PE, as it would definitely remove the incentive for MNEs to continue with such practices.

Through precise action in article 5 (3) OECDMC Commentary, the recommended course of action focuses on the cause of the method used by MNEs and removes it, rendering those practices ineffective in the avoidance of PE status.

With this specific anti-abuse provision, the PE status' risk would be significantly augmented for any person actively engaged in the project PE's realm, and it would

likely give rise to a substantial increase in PEs in source countries. Even more so considering that, should this specific anti-abuse provision be implemented, all enterprises carrying out activities similar to the ones mentioned in our example and in the same manner, would have a PE in the Source Country.

This increase in PEs and the recovery of source taxation is one of Action 7's objectives and the recommended path addressed herein adheres to it and could effectively assist in reaching it, yet such an objective must be well-guided and cannot become absolute, it is important to have perspective and consider potential side-effects.

One commendable aspect of this solution relies on the path chosen in Action 7, recovering the contractor/subcontractor provision but improving it by extending its effect to all parties involved in the artificial avoidance practices, as otherwise the effect of this provision would be curtailed and its application only to a "main" enterprise would render it extremely prone to abuse. Aside from the difficulty of defining and designing a valid provision that would only target that enterprise, such an option would allow the other involved parties to benefit from their avoidance practices by falling short of the 12-month test and the PE status.

Furthermore, Action 7's solution managed to prevent potential nefarious side-effects by recommending a specific anti-abuse provision standing on a facts and circumstances approach, as this limits an otherwise broad solution, meaning that enterprises that split contracts for genuine reasons, absent tax objectives, should not be under its scope. Such a stance is important as it refrains tax administrations from taking more aggressive actions upon receiving new ammunition[388].

Notwithstanding the above, this proposed solution is not without concerns, and even though we are broadly in agreement with it, certain aspects should be revised before its implementation.

One of such concerns relates to the new connected activities concept, as even though the proposed additions to article 5 (3) OECDMC Commentary provides some guidance on the interpretation of this concept in the context of the anti-splitting provision, the level of guidance provided is simply insufficient, especially

[388] MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 71.

considering that it is a new concept and a pivotal element to the application of this provision[389].

In this sense, additional guidance for interpreting this concept, covering its essential elements as well as examples of concrete situations where activities are connected and where they are not, would be vital to this provision, which would also increase legal certainty both for tax administrations applying this provision and for enterprises structuring their cross-border ventures.

The legal uncertainty arising from the lack of sufficient guidance on a new pivotal element of the project PE, together with a lower threshold, means that disputes would also see an increase in source countries, with MNEs and tax administrations arguing on whether or not activities are connected and the enterprise has a PE therein[390].

Also, the lower PE threshold that would be introduced by this proposed solution, means increased administrative burdens for both tax administrations and MNEs, which we see as a necessary consequence of the much-needed provisions to prevent abusive practices, as well as the expected increase in MNEs' tax burden. However, these increased administrative burdens to all stakeholders should be matched by the benefits collected through them, meaning an effective increase in source taxation and revenue[391].

Still, we find that these benefits might be slim when the provision applies to enterprises that have a short activity, 1 or 2 months, in a site/project in the Source Country as part of a group of enterprises that split a contract amongst several enterprises and that the overall extension surpasses the 12-month test[392].

In this scenario, it is important to recall our comments on the relationship between article 5 (1) and (3) 2014 OECDMC and that to reach the project PE status, the relevant enterprise still has to comply with the tests of the physical PE to some extent, such as the *locus* or *situs* test. One aspect that has not been dealt with, is whether, considering the application of the aggregated time to all enterprises and the scenario presented above, the physical PE's *tempus* test will have some

[389] *Ibid*.
[390] *Ibid*.
[391] CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 510.
[392] *Ibid*.

significance or whether the 12-month test will continue to be the only relevant time test.

Furthermore, we find that the solution proposed would be more effective if it was introduced as an amendment to article 5 (3) 2014 OECDMC's wording directly, leaving in the Commentary the necessary guidance to assist this provision. A direct amendment to the wording would be a more effective method to dissipate implementation doubts and legal uncertainty amongst countries.

Moreover, coordination and cooperation are vital to prevent the artificial avoidance of PE status and in this solution, Action 7 failed to achieve a single and closed solution to the identified problem, instead, it offered several routes to a troublesome issue, thus divergent country practices ought to soar. Having different means to combat the same foe will inevitably lead to loopholes and mismatches, which are most welcomed by MNEs, even where those different means are based on anti-abuse provisions[393]. Therefore, more was expected from Action 7's proposed solution in this regard.

Considering the above, and despite the need to revise certain aspects, some carrying grave impacts, we find that the path proposed in Action 7 against the splitting-up of contracts' practices carried out by MNEs is a fit solution to prevent the artificial avoidance of project PE status when considering the underlying causes and practices. A new standard would be created, effectively lowering the PE concept's threshold by aggregating time spent by closely related enterprises in connected activities, thus abolishing this BEPS strategy and similar ones that could be introduced.

Having presented and explained the first of the MNE's BEPS strategies identified in Action 7, we will proceed onto the second strategy to avoid PE status, which we will be dividing into two different features, each being taken advantage of by MNEs in different manners and with different solutions against it.

[393] DOURADO, Ana Paula – *Governação Fiscal Global*… p. 102.

2.3.2. Article 5 (4) 2014 OECDMC – nature of the preparatory or auxiliary activities' exemption

From this subsection's title, one can deduce that the second BEPS strategy typically used by MNEs, and that has been identified in Action 7, originates from article 5 (4) 2014 OECDMC and its specific activity exemptions regarding preparatory or auxiliary activities.

Considering the causes and practices of this BEPS strategy, as well as the proposed course of action in Action 7 against it, we prefer to detach it into two different, although connected, features that MNEs often take advantage of to avoid PE status.

In this subsection, we will expose the first feature of MNEs' abusive strategy on article 5 (4) 2014 OECDMC's negative catalogue, which is strongly related to our comments in Chapter 1 regarding the structure of this article and its interpretation, as well as explain the amendments proposed in Action 7 against this strategy.

2.3.2.1. Causes and practices

Further to our comments on subsection 1.4.2, and despite the debate on this matter, our understanding is that article 5 (4) 2014 OECDMC is divided into two compartments, the first includes paragraphs (a) to (d) and the other is comprised by paragraphs (e) and (f). The crux of this division lies in the interpretation and application of the paragraphs included in both compartments based on the 2014 OECDMC and its Commentary.

We understand that the paragraphs included in the first compartment are automatic deeming exceptions that exclude persons engaged in such activities from reaching the PE status' threshold, as they were traditionally by nature preparatory or auxiliary. On the contrary, the second compartment's paragraphs are not automatic exceptions, instead, they require thorough analysis to assess whether the relevant activities possess a preparatory or auxiliary character.

In connection with our views on this subject, Action 7 also refers to the work the OECD has done in attempting to clarify this understanding as the one intended for

article 5 (4) 2014 OECDMC[394]. Yet, even within the OECD, there is no consensus on the structure and interpretation of this provision's paragraphs, meaning that OECD member countries diverge in their understanding of whether all activities need to qualify as having a preparatory or auxiliary character to be excluded from reaching the PE status or if some activities have that character inherently due to their nature[395].

The absence of a consensus on this matter regrettably leads to divergent practices between countries. This divergence is most welcomed by MNEs, as they may exploit them to structure their cross-border endeavours following their intent to avoid PE status since such mismatches and loopholes are the playground for MNEs active in BEPS practices and seeking to lower their overall taxation[396].

This first feature of the second BEPS strategy results from the mentioned divergent practices between countries. Also, as we will see, even Action 7's proposed amendments against this strategy reveal the lack of harmony within all parties involved in this matter.

It is important to note that this first feature is unique to countries that follow the understanding that we advocate, being that only in those countries do the paragraphs of the first compartment give rise to the BEPS practices and concerns acknowledged herein[397].

Effectively, MNEs clawed onto those loopholes and executed strategies in countries that allowed them to avoid PE status therein. The tax planning strategy for such countries relies on the ability that MNEs' activities carried out therein have to benefit from the automatic deemed exclusions of PE status whenever they fall within paragraphs (a) to (d) of article 5 (4) 2014 OECDMC, and regardless of whether or not such activities truly have a preparatory or auxiliary character[398].

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394 OECD – *Preventing the Artificial*… p. 28.
395 *Ibid*.
396 *Ibid*; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 560; GILLESPIE, John – *The Base Erosion*… pp. 21-22; BRAUNER, Yariv – *Treaties in the*… pp. 1007-1008.
397 OECD – *Preventing the Artificial*… p. 28; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 308.
398 GILLESPIE, John – *The Base Erosion*… p. 21; PLEIJSIER, Arthur – *The Artificial Avoidance of Permanent Establishment Status: A Reaction to the BEPS Action 7 Final Report*. International Transfer Pricing Journal. Volume 23, number 6 (2016) p. 445; KAROLYI, Balazs – *The Challenges of*… pp. 44-45; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 507; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 560.

On the contrary, in countries that do not follow our understanding, those activities must still undergo scrutiny on their true character, *i.e.* if they are indeed preparatory or auxiliary, or not. This difference by itself is already prone to tax planning, as in these countries the PE status' risk for MNEs is higher vis-à-vis the other countries.

The activities listed in article 5 (4) (a) to (d) 2014 OECDMC were traditionally preparatory or auxiliary by nature, meaning that in the existing business panorama such activities were considerably remote to the traditional income-generating core activities, as such, the automatic deeming exclusion should be suited vis-à-vis the PE concept and the international taxation principles at play in this regard[399].

In this sense, no BEPS concerns or artificial avoidance should exist, given that, considering its purpose, the automatic deeming exemptions in article 5 (4) (a) to (d) 2014 OECDMC have been working properly, since the activities listed therein should not constitute core income-generating activities and thus MNEs' activities that fall within these exemptions should be the ones specifically intended to do so[400].

However, Action 7 found such MNEs' strategies because this feature's cause is not exclusively the interpretation that countries adopt by reference to article 5 (4) (a) to (d) 2014 OECDMC and the automatic deeming exemptions, in fact, their true cause arises from the combination between this and a core problem of the 2014 OECDMC's PE concept, which is the failure to accompany the evolution of the way cross-border businesses are carried out[401].

With effect, technology evolved and allowed MNEs to carry on their cross-border activities in ways not thought of before, and nowadays it is fairly easy for MNEs to be able to conduct businesses in another country with limited to no presence therein, which was only made possible due to the rise of economic dematerialisation and the streamlining of the internet for this purpose[402].

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[399] CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 507; KAROLYI, Balazs – *The Challenges of*… pp. 44-45.
[400] *Ibid*.
[401] *Ibid*; GILLESPIE, John – *The Base Erosion*… p. 21; AMORIM, Ana Teresa Machado Rodriguez – *Ação 7 do BEPS: a utilização do artigo 5.º 4 da Convenção Modelo da OCDE como instrumento de planeamento*. 2017. Braga. Master thesis. p. 9; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 308; PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 445.
[402] DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 308; KAROLYI, Balazs – *The Challenges of*… pp. 44-45; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 507; AMORIM, Ana Teresa Machado Rodriguez – *Ação 7* do… p. 36.

This evolution created new business models and economic sectors that quickly exploded in terms of their global value, attracting (and creating) MNEs, some of which engaged in BEPS practices identified in Action 7[403]. These business models and economic sectors' activities broke the chains of tradition and wreak havoc within article 5 (4) 2014 OECDMC because the once traditionally preparatory or auxiliary activities were now core or vital activities of these business models, such as supply chain operations or the collection of information[404].

This fact is particularly relevant in the e-commerce sector and others alike, in which some well-known companies stand out, both in market share and in BEPS practices, considering that their internet-based business models allow them to sell their products with a limited presence abroad, usually only its territorial or regional supply chain (essentially warehousing for storing and delivery of products)[405].

This sector, and the ones included in the first feature of the second BEPS strategy, modernized and compacted traditional business models by replacing most of their physical presence needs with the internet, however, they could not replace them entirely, meaning that the ones left are vital for their core activity, be it selling merchandise, information, or others.

The ability to globally conduct this type of business activities (semi-internet based) allows MNEs to have their basis of operations at any point of the world, but there still is a need to provide the client with their products or to obtain the product itself, requiring a local/regional physical presence (*e.g.,* information for the news or the life sciences sector and e-commerce), a core element of that activity[406].

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[403] PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 445; GILLESPIE, John – *The Base Erosion*… p. 28.
[404] GILLESPIE, John – *The Base Erosion*… pp. 21-22; AMORIM, Ana Teresa Machado Rodriguez – *Ação 7* do… pp. 14-15; DE WILDE, Maarten Floris – *Lowering the Permanent*… pp. 560-561; Kevin – *The Post-BEPS World*… p. 507; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 308; KAROLYI, Balazs – *The Challenges of*… pp. 44-45; RIBEIRO, Cláudio de Paiva – *A tributação do*… p. 54.
[405] GILLESPIE, John – *The Base Erosion*… pp. 21-23; KAROLYI, Balazs – *The Challenges of*… pp. 44-45; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 507; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 308; PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 445; RIBEIRO, Cláudio de Paiva – *A tributação do*… p. 56.
[406] GILLESPIE, John – *The Base Erosion*… pp. 21-23; KAROLYI, Balazs – *The Challenges of*… pp. 44-45; PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 445; RIBEIRO, Cláudio de Paiva – *A tributação do*… p. 56; SPINOSA, Lisa; CHAND, Vikram – *A Long-Term Solution for Taxing Digitalized Business Models: Should the Permanent Establishment Definition Be Modified to Resolve the Issue or Should the Focus Be on a Shared Taxing Rights Mechanism?*. Intertax. Volume 46, issue 6 & 7 (2018) pp. 485-486.

Action 7 demonstrates that MNEs active in these newer sectors and business models sheltered their activities in the safe harbours provided by article 5 (4) (a) to (d) 2014 OECDMC and the automatic deeming exemptions, thus giving rise to BEPS concerns and the avoidance of PE status.

For instance, Company A, resident in Country R, is an online retailer that sells its products worldwide. Country S and Country N, border countries, are home to most of Company A's customers, representing over 50% of its worldwide sales. Company A needs to set up a local supply chain operation to serve those customers. Considering that Country S follows the view that article 5 (4) (a) to (d) 2014 OECDMC are automatic deeming exemptions, unlike Country N, Company A chooses Country S for its supply chain, by acquiring a warehouse to store and deliver its products to customers in both countries, thus artificially avoiding PE status in both countries.

Therefore, in a country that follows the automatic deeming exclusions' view of article 5 (4) (a) to (d) 2014 OECDMC, if a MNE's business activity's core or vital elements consist of one of the activities listed in these paragraphs, then it would benefit from the PE status' exclusion, even though that activity clearly does not have a preparatory or auxiliary character[407].

In this sense, MNEs whose core businesses consist of the activities listed in article 5 (4) (a) to (d) 2014 OECDMC could target those countries to deliberately carry on their cross-border ventures without taking into account any PE risk, hence avoiding source taxation and reducing their overall tax burden[408].

These MNEs were abusively benefiting from the exemptions of article 5 (4) 2014 OECDMC by distorting their purpose and spirit since clearly those sectors' activities cannot be regarded as preparatory or auxiliary by nature[409]. Therefore, this should have prompted either an update of the automatic deeming exemptions or their elimination as such.

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[407] GILLESPIE, John – *The Base Erosion*… p. 21; PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 445; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 507.
[408] DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 560.
[409] KAROLYI, Balazs – *The Challenges of*… p. 45; GILLESPIE, John – *The Base Erosion*… p. 21; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 561; PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 445.

For countries that abide by the theory that article 5 (4) 2014 OECDMC does not have any automatic deeming exemptions this first feature of the BEPS strategy is ineffective and those activities of the newer business models would likely reach the PE status therein.

In light of the above, the causes and practices of this first feature of the second BEPS strategy are now clear and, at the same time, it is also clear the course of action needed to address these practices, which will be revealed next, as we advance onto the amendments and solutions proposed under Action 7 to counter them.

2.3.2.2. Amendments and solutions

Following our explanation above on the causes and practices and our peek on the course of action needed to combat this strategy, we will now present and explore the amendments proposed in Action 7 to eliminate both this strategy and the artificial avoidance of PE status based on the nature of article 5 (4) (a) to (d) 2014 OECDMC.

These new business models shook and modified the foundation upon which article 5 (4) (a) to (d) 2014 OECDMC stood. The automatic deeming exemptions prescribed in those paragraphs became inadequate to deal with these new business models, in which the simple storage and delivery of a product is a quintessential element of the whole activity. The current reality is far from the one existing at the time the OECD designed these paragraphs and introduced them as automatic deeming exemptions.

Without a doubt, in the e-commerce sector, the supply chain operations are an essential element that is far from being remote to its core business activity (selling products), as is the collection of information for the news media sector and others akin, therefore, claiming refuge under article 5 (4) (a) to (d) 2014 OECDMC exemptions is warping the sanctuary this article provides for activities with a true preparatory or auxiliary character[410].

[410] GILLESPIE, John – *The Base Erosion*… pp. 21-23; PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 445; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 507; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 308.

Action 7 found that MNEs managed to avoid PE status regarding core or vital business activities due to article 5 (4) (a) to (d) 2014 OECDMC's inability to keep pace with the cross-border business models that have been in play for quite some time, especially in the e-commerce sector and others akin.

Yet, this is not so clear-cut as it might seem, since, in what is becoming customary, there was no consensus between the countries engaged in Action 7 over what gave rise to BEPS concerns within this provision, with some arguing that this first feature did not give rise to BEPS concerns and in that way, the automatic deeming exemptions' paragraphs should not be changed as to prevent the practices mentioned above[411].

For these countries, the true BEPS concerns derive from the second feature, which we will explain further along, and the OECD allows these countries to only implement the amendments proposed against that second feature, and not the ones discussed herein, as we will see below[412].

In a nutshell, these countries deny the causes previously commented and still regard article 5 (4) (a) to (d) 2014 OECDMC as adequate in the current panorama because these activities are, by nature, preparatory or auxiliary, therefore they do not adhere to the amendments proposed in Action 7 for this first feature[413].

Regardless of the position taken by those countries, we do not agree with it, as it may result from our exposition on the causes and practices of this first feature. We understand that the automatic deeming exemptions are no longer adequate in the current economic panorama and that they gave rise to serious BEPS concerns since article 5 (4) (a) to (d) 2014 OECDMC is severely outdated.

In this sense, we recognise that only through amendments could article 5 (4) (a) to (d) 2014 OECDMC recover its original purpose, which is to exclude from the PE status activities with a preparatory or auxiliary character, without being a cause and source for artificial avoidance practices of such status. Amendments that were in dire need.

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411 OECD – *Preventing the Artificial*… p. 28; GILLESPIE, John – *The Base Erosion*… pp. 38-39.
412 *Ibid*; BARBIER, Casper – *The Permanent Establishment*… p. 58; AMORIM, Ana Teresa Machado Rodriguez – *Ação 7* do… p. 42.
413 OECD – *Preventing the Artificial*… p. 28; GILLESPIE, John – *The Base Erosion*… pp. 38-39.

Setting aside these preliminary comments on the particularities of the second BEPS strategy's first feature, we will now focus on the proposed amendments and solutions, which are essentially dedicated to lowering the PE concept's threshold by requiring that all paragraphs of article 5 (4) OECDMC be subject to scrutiny on whether they effectively have a preparatory or auxiliary character[414].

As per Chapter 1, and when they exist, we will showcase the proposed amendments to article 5 (4) 2014 OECDMC itself to provide a clear notion of the amendments, which will be identified via strikethrough (regarding the items eliminated) and underline (regarding the items added).

Action 7's course of action for these amendments is two-fold, first a key modification to article 5 (4) 2014 OECDMC's wording that eliminates the automatic deeming exemptions, and second, the Commentary is revised to provide further guidance on the amendments' purpose and clarify the interpretation and application of this provision[415].

As commented, the key issue was that core or vital MNEs' activities were benefiting from the safe harbour provided by the automatic deeming exemptions, regardless of their true character, therefore, this ruse needed to be fought directly. This concern seems to be present in Action 7's proposed modification to article 5 (4) 2014 OECDMC:

"*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;

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414 GILLESPIE, John – *The Base Erosion*… p. 27; KAROLYI, Balazs – *The Challenges of*… p. 45; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 308; WETTERSTEN, Maria – *How can the*… pp. 18-19.

415 OECD – *Preventing the Artificial*… pp. 28-38; GILLESPIE, John – *The Base Erosion*… p. 26; MEHTA, Amar – *Chapter 4: The*… pp. 5-6; KAROLYI, Balazs – *The Challenges of*… p. 45; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 308; WETTERSTEN, Maria – *How can the*… pp. 18-19.

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.~~,

provided that such activity or, in the case of subparagraph f), the overall activity of the fixed place of business, is of a preparatory or auxiliary character"[416]

With this proposed amendment all paragraphs would be subject to the preparatory or auxiliary test, by moving the debated provisions from paragraphs (e) and (f) to the end of the provision as an encapsulating measure, marking the first time paragraphs (a) to (d) would be subject to such test[417].

Even though it is a fairly simple amendment, it would culminate in an actual lower PE threshold by reducing the exemptions' scope, since previously the activities included in the first four paragraphs of article 5 (4) 2014 OECDMC would be automatically excluded and now they still need to surpass the preparatory or auxiliary test, thus substantially increasing the PE status' risk for MNEs[418].

Through this proposed amendment, any activity seeking sanctuary in any of article 5 (4) 2014 OECDMC's paragraphs will need to be analysed against the business activities carried out by the relevant MNEs to assess whether they have a preparatory or auxiliary character or not, *i.e.* if they are to give rise to a PE or not, and not elude PE status by simply being a listed activity[419]. This analysis also reveals a greater focus on a factual and economic approach to this article rather than a

[416] OECD – *Preventing the Artificial*… pp. 28-29.
[417] GILLESPIE, John – *The Base Erosion*… p. 27; MEHTA, Amar – *Chapter 4: The*… p. 6; WETTERSTEN, Maria – *How can the*… p. 18.
[418] GILLESPIE, John – *The Base Erosion*… p. 27; WETTERSTEN, Maria – *How can the*… pp. 20, 25.
[419] KAROLYI, Balazs – *The Challenges of*… p. 45; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 308; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509.

straight formal and legal approach, together with increased subjectivity regarding the core business activities[420].

When considering the type of MNEs addressed earlier, their activities were carried out without proper concern over PE status' risk, due to the safe harbour of the automatic deeming exemptions, meaning that it is likely that the above amendment will lead to an increase of activities reaching the PE status and increased taxation in source countries[421].

Although the activities listed in article 5 (4) (a) to (d) 2014 OECDMC were traditionally preparatory or auxiliary, in the newer business models those very same activities can be core or vital activities which should not be eligible for this provision's exemptions, yet they still were.

In this sense, it is expected that this shift in article 5 (4) 2014 OECDMC will mean that those activities will fail the preparatory or auxiliary test and constitute PEs in source countries, thus eliminating the artificial avoidance of this status, assuming they qualify under article 5 (1) 2014 OECDMC[422].

This proposed amendment intends to accomplish two important objectives, eliminating the artificial avoidance of the PE status and bringing a solution to the debate regarding the structure and nature of this provision, both by submitting all paragraphs of article 5 (4) OECDMC to the preparatory or auxiliary test.

With this overarching test, there would no longer be discussions on whether paragraphs (a) to (d) are preparatory or auxiliary by nature or if instead they still need to be subject to this test's analysis[423]. The absence of this discussion would also bring further clarity and certainty to the international taxation panorama by having a harmonious interpretation of article 5 (4) OECDMC[424].

The expected increase of PEs is an objective of Action 7 so that taxation may return to where it has been lacking through artificial tax strategies[425].

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[420] GILLESPIE, John – *The Base Erosion*… pp. 28, 41-42; BARBIER, Casper – *The Permanent Establishment*… p. 59.
[421] GILLESPIE, John – *The Base Erosion*… pp. 27-29; WETTERSTEN, Maria – *How can the*… pp. 20, 25.
[422] GILLESPIE, John – *The Base Erosion*… pp. 28-29; WETTERSTEN, Maria – *How can the*… pp. 20, 25.
[423] GILLESPIE, John – *The Base Erosion*… p. 27; WETTERSTEN, Maria – *How can the*… p. 25.
[424] GILLESPIE, John – *The Base Erosion*… p. 39; WETTERSTEN, Maria – *How can the*… p. 25.
[425] WETTERSTEN, Maria – *How can the*… p. 20.

Notwithstanding, this objective has risks and concerns associated, namely unintended spillover effects.

Having made clear that the proposed amendment to article 5 (4) 2014 OECDMC's wording is critical to invalidate this first feature of the second BEPS strategy, it is important to state that the solution presented in Action 7 also introduces complementary modifications to that provision's Commentary to clarify its interpretation and application[426].

Considering the wording of article 5 (4) OECDMC as recommended by Action 7, it is obvious that the preparatory or auxiliary test will be even more relevant for this provision, and, as commented, this test was not without issues[427].

In this sense, Action 7 recommends modifications to the Commentary to streamline the wording adjustments, to shed light on what is "preparatory" and "auxiliary", clarifying that they are indeed two separate and different elements of this test, and on the activities that may be included in each of article 5 (4) OECDMC's paragraphs, which is highly important, especially regarding paragraphs (a) to (d)[428].

To this end, the examples prescribed in the Commentary's projected amendments are particularly useful in identifying interpretative elements for the fulfilment of the preparatory or auxiliary test by reference to each of article 5 (4) OECDMC's paragraphs[429].

Also, the recommended amendments to the Commentary reiterate that article 5 (4) OECDMC functions as an exception to the physical PE concept of article 5 (1) OECDMC and that the listed activities will only be deemed to be excluded when they have a preparatory or auxiliary character[430].

On paragraph (e), the view that it functions as a general limitation to article 5 (1) OECDMC is maintained, as a backstop to the qualification as PE for activities that have a preparatory or auxiliary character but are not listed in the other paragraphs[431].

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[426] MEHTA, Amar – *Chapter 4: The*… p. 6; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 308; WETTERSTEN, Maria – *How can the*… p. 18.
[427] OECD – *Preventing the Artificial*… pp. 29-38; KAROLYI, Balazs – *The Challenges of*… p. 45.
[428] *Ibid*; WETTERSTEN, Maria – *How can the*… p. 18.
[429] WETTERSTEN, Maria – *How can the*… p. 19.
[430] OECD – *Preventing the Artificial*… p. 29.
[431] *Ibid*.

Action 7 also puts forward a suggestion for a definition of the preparatory and auxiliary concepts, under which "preparatory" applies to any activity that precedes and somewhat prepares the enterprise's core activity[432]. The proposed Commentary resorts to a time criterion for these activities, as they should be short-lived, however, this is not a closed definition and the proposed Commentary foresees that preparatory activities can also be carried out for extended periods of time, depending on the relevant enterprise's core activity[433].

In its turn, "auxiliary" applies to activities that play a supportive role on the enterprise's core activity but that are not part of it, also, these activities should be fairly insubstantial in relation to the assets/personnel of the enterprise it needs to be carried out, otherwise, the auxiliary character is less likely[434].

Contrary to Action 7's take on the wording of article 5 (4) 2014 OECDMC, the above-proposed modifications to the Commentary serve the purpose of bringing much-needed clarity and guidance on the elements already present therein.

Beyond those two relevant concepts' definition, Action 7's amendments to the Commentary focus on minor adjustments and clarifications to the main aspects addressed in the preceding Chapter and provides new examples of activities for each of article 5 (4) OECDMC's paragraphs.

One of these relevant examples relates to our comments on e-commerce business activities, as Action 7's proposed modification refers to an enterprise that maintains a warehouse in the Source Country with a considerable number of employees for the storage and delivery of its own products that it sells online to customers of that country, and states that this activity does not have a preparatory or auxiliary character since it constitutes an essential part of the enterprise's business activity[435].

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[432] OECD – *Preventing the Artificial*… p. 30; KAROLYI, Balazs – *The Challenges of*… p. 45; WETTERSTEN, Maria – *How can the*… pp. 18-19; AMORIM, Ana Teresa Machado Rodriguez – *Ação 7 do*… p. 39.

[433] OECD – *Preventing the Artificial*… p. 30; WETTERSTEN, Maria – *How can the*… p. 19; AMORIM, Ana Teresa Machado Rodriguez – *Ação 7 do*… p. 39.

[434] OECD – *Preventing the Artificial*… p. 30; KAROLYI, Balazs – *The Challenges of*… p. 45; WETTERSTEN, Maria – *How can the*… pp. 18-19; AMORIM, Ana Teresa Machado Rodriguez – *Ação 7 do*… p. 39.

[435] OECD – *Preventing the Artificial*… p. 31; SPINOSA, Lisa; CHAND, Vikram – *A Long-Term Solution*… pp. 485-486.

An important note on this proposed example is that the assessment of the preparatory or auxiliary character needs to be conducted by taking into account the facts and circumstances of the enterprise's overall business activity, since, as discussed, that same activity may have different contours in different economic sectors and business activities, *e.g.* a warehouse solely for the delivery of spare parts to customers that bought machinery would have an auxiliary character[436].

Some of the examples proposed in Action 7 go to the umbilical relationship between article 5 (1) and (4) OECDMC since article 5 (4) OECDMC only applies where the relevant enterprise fulfils the physical PE's criteria, such as the *situs* test, otherwise, there is no need to venture into the exemptions' tests[437].

Action 7's recommended addendums to the Commentary also include an important example by reference to paragraph (d) and to purchasing activities. It is stated that the preparatory or auxiliary character does not apply to purchasing activities where the core activity of the relevant enterprise is selling those acquired goods and the purchasing activity is a core element of the enterprise's overall business activity[438].

This would be the case of procurement activities that require specialized skills and knowledge on the acquisition process to guarantee the quality or type of product that is afterwards sold, such as gems or agricultural products, this purchasing activity forms an essential part of the enterprise's overall activity[439].

Contrary, in the second half of paragraph (d), on the collection of information, Action 7's proposed Commentary states that having an office for the simple collection of information by an investment fund seeking investment opportunities or by a newspaper company seeking possible news in that country would be considered as a preparatory activity and no PE would arise[440].

Even though we understand the purpose of this example, we cannot adhere to it in an extrapolation to all news enterprises, especially those in the newer internet-based sectors, since the collection of information through an office for news stories

[436] OECD – *Preventing the Artificial*… p. 31; RIBEIRO, Cláudio de Paiva – *A tributação do*… p. 56.
[437] OECD – *Preventing the Artificial*… pp. 32-34.
[438] OECD – *Preventing the Artificial*… p. 33.
[439] *Ibid*; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 152-153.
[440] OECD – *Preventing the Artificial*… p. 34.

is an essential element of that business activity and cannot be regarded as having a preparatory character, it is substantially different from the collection of information for the investment fund and is much more closer to the significance of procurement activities. Different sectors require a different analysis considering the factors of the overall business activity.

Furthermore, Action 7's proposed adjustments to the Commentary also state the new nature of the first compartment as a non-comprehensive illustrative list of common activities that often have a preparatory or auxiliary character, which cements the vital modification proposed to the wording and the recommended new life of these paragraphs[441]. Yet, a question arises on this topic as to the need to maintain such an illustrative set of examples when paragraph (e) has an overarching reach to cover all activities with a preparatory or auxiliary character[442].

The last noteworthy element of Action 7's proposed Commentary is precisely the one that deserves the most critique, as mentioned, since Action 7 proposes that the countries that continue to follow the view that the first compartment's paragraphs are intrinsically preparatory or auxiliary can continue to apply article 5 (4) OECDMC without any modification and may eliminate some of its first paragraphs as they see fit, to subject them to the preparatory or auxiliary test[443].

Also, these countries share the view that any BEPS concerns arising from this provision should only be addressed by the amendments and solutions referred to in the next subsection about the second feature of this second BEPS strategy[444].

As commented, and as the OECD as stressed through its deliverables on the BEPS Project, cooperation and coordination are crucial if the war against the artificial avoidance of PE status is to be won, and to recoup both the source-residence equilibrium and the balance in the international taxation system concerning the fair allocation of taxing rights, especially where value is created[445].

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[441] *Ibid*.
[442] KAROLYI, Balazs – *The Challenges of*… p. 45; CUNNINGHAM, Kevin – *The Post-BEPS World*… pp. 507-509.
[443] OECD – *Preventing the Artificial*… p. 38; AMORIM, Ana Teresa Machado Rodriguez – *Ação 7 do*… p. 42; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 508.
[444] OECD – *Preventing the Artificial*… p. 38.
[445] DOURADO, Ana Paula – *Governação Fiscal Global*… pp. 40, 54; ROSDINA, Haula; TAMBUNAN, Maria R.U.D.; IRIANTO, Edi Slamet – *Review of Implementation of the Inclusive Framework on Base Erosion and Profit Shifting in Indonesia*. Intertax. Volume 47, issue 6 & 7 (2019) p. 638.

However, the leeway granted by Action 7 in proposed provisions, such as the one mentioned above, undermine these efforts and are a potential cause for greater disunity and divergent country practices, which led to BEPS practices in the first place.

2.3.2.3. Analysis

By this point, we explained the amendments and solutions proposed in Action 7, providing a clearer picture of their aftereffects on all stakeholders in the international taxation system and specifically their accuracy vis-à-vis the target. Action 7's proposed amendments and solutions can only be appraised bearing in mind the issues they seek to correct, namely the causes and practices explained.

In this sense, Action 7 proposes a valid course of action against the first feature of the second BEPS strategy. The direct amendments to article 5 (4) 2014 OECDMC would dissipate doubts as to its application and minimize the discussions as to the nature of each paragraph, thus mitigating divergent country practices and limiting MNEs' BEPS capabilities and increasing legal certainty[446]. This course of action homes in on the epicentre of these BEPS practices and removes their cause by subjecting all paragraphs to the preparatory or auxiliary test.

Through this proposal, Action 7 would be successfully lowering the PE concept's threshold, since it is reducing the scope of the exclusions by abandoning their automatic application and placing a test that must be surpassed[447]. With a lower threshold, the PE status' risk spikes and this recommended solution should lead to an increase in PEs in source countries, hence complying with the objective of recovering source taxation and balancing the fair taxation's scales.

Such occurrence would inevitably cause a relevant aftershock, which is the increased tax and administrative burden placed on taxpayers. With an increased PE status' risk, taxpayers will now have an increased administrative burden to assess and evaluate their activities vis-à-vis the new PE threshold, especially those that did

[446] WETTERSTEN, Maria – *How can the*… p. 25; GILLESPIE, John – *The Base Erosion*… pp. 27, 39; AMORIM, Ana Teresa Machado Rodriguez – *Ação 7 do*… p. 38.
[447] WETTERSTEN, Maria – *How can the*… pp. 20, 25; GILLESPIE, John – *The Base Erosion*… pp. 27-28.

not have such concern previously, and possibly an added tax burden with the effective qualification as a PE[448].

However, this increased burden should have an immaterial impact on cross-border ventures as MNEs already have this concern on other countries (those that never followed the automatic deeming exemptions) and the economy should not be affected, *i.e.* demand for MNEs' activities will continue to exist. Also, these burdens are a necessary consequence to the surgical renovation needed in article 5 (4) 2014 OECDMC to prevent the artificial avoidance of PE status, now all taxpayers stand equal with the administrative burden of assessing their activity's true character[449].

The intent to reduce the PE's threshold is a common feature throughout Action 7 to prevent the artificial avoidance of PE status as a means to catch in this net the once elusive MNEs. Nonetheless, this intent needs to be balanced and refrained considering the side-effects and aftershocks it may cause where they were not needed or desired, such as impacting non-artificial and non-abusive tax structuring designs.

The aforementioned solutions also demonstrate a concern with providing further guidance on the Commentary, which is a general critique we made to the 2014 OECDMC, especially in the aspects that now have greater importance within this provision, such as the preparatory and auxiliary concepts and the reach of each paragraph[450].

Notwithstanding, Action 7 has flaws and downfalls, some already addressed, and considering the magnitude of the issue at hand and its objective, Action 7 should have met the high expectations created around it.

Despite the expected difficulties, a major flaw lies in the grave inability to reach a consensus and unanimous position against the causes and practices of this second BEPS strategy's first feature, with some countries denying its obvious existence[451]. This flaw, in its turn, leads to cherry-picking amendments and solutions out of

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[448] WETTERSTEN, Maria – *How can the*… p. 27; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 508; GILLESPIE, John – *The Base Erosion*… pp. 28, 40-41.
[449] GILLESPIE, John – *The Base Erosion*… pp. 27, 41.
[450] KAROLYI, Balazs – *The Challenges of*… p. 45; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 508; WETTERSTEN, Maria – *How can the*… pp. 18-19.
[451] CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 508; GILLESPIE, John – *The Base Erosion*… pp. 38-39.

Action 7, by allowing these oblivious countries to choose what to effectively implement from the recommended course of action.

Furthermore, the simple preservation of article 5 (4) OECDMC's first compartment of paragraphs is redundant given that Action 7 reiterates paragraph (e) as an encapsulating restrictive clause and renders the first four paragraphs as a mere illustrative list of common preparatory or auxiliary activities[452]. Considering this provision's historic background and the countries' positions on it, a bolder action was expected, such as eliminating those first four paragraphs.

Otherwise, should a consensus exist over keeping this illustrative list, an alternative solution could be to upgrade and revitalize it by expanding its scope to expressly include activities related with the DAPE and with the newer business models.

The option to shift from a legal and objective approach to the more factual/economic approach chosen by Action 7 in its proposed amendments and solutions should also be taken with caution, despite being commendable for its effectiveness against spillover effects, such as assessing each activity bearing in mind the facts and circumstances that surround the enterprise's business activity and preventing its artificial manipulation.

The proposed shift of approach has attached increased legal uncertainty for both taxpayers and tax administrations and increased subjectivity, which are likely to give rise to more disputes between both parties on the qualification as PE[453].

Another aspect that deserves concern is the impact this proposed modification would have on the tax administrations' activity, given that with a lower threshold supported in an economic analysis there is a risk that tax administrations may become more aggressive and actively seeking PEs by exploring greyer areas, which is likely to lead to disputes with taxpayers, as these will have to dismiss the qualification made by tax administrations.

Although improvements are still required, overall, Action 7's recommended adjustments would be setting a new standard in respect to article 5 (4) OECDMC and

[452] KAROLYI, Balazs – *The Challenges of*… p. 45; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 507.
[453] CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 508; GILLESPIE, John – *The Base Erosion*… pp. 28, 41-42.

effectively preventing the artificial avoidance of PE status through the abusive usage of the preparatory or auxiliary activities' exemption.

With this final note, we showcased and analysed the overall aspects of Action 7's proposed amendments and solutions against this second BEPS strategy's first feature, exposing its merits and downfalls, which leads to our conclusion that, considering its objective, this is a suitable option to prevent the artificial avoidance of PE status.

In the following subsection, we will move onto this second BEPS strategy's second feature, introducing its causes and practices, and analysing an innovative solution to prevent them.

2.3.3. Article 5 (4) 2014 OECDMC – fragmentation of activities and the preparatory or auxiliary activities' exemption

Continuing with our expedition through the BEPS strategies' causes and practices and Action 7's recommended solutions against them, in this subsection, we will address the second feature of the second BEPS strategy, which also take advantage of article 5 (4) 2014 OECDMC's negative catalogue exemptions.

Yet, the method used by MNEs to artificial avoid the PE status in this second feature is distinct from the one of the first feature, instead, it shares some similarities with the contract splitting practices of the first BEPS strategy.

2.3.3.1. Causes and practices

As noted in Chapter 1, article 5 (4) 2014 OECDMC consists of a negative catalogue of activities that will not be deemed to give rise to a PE. Therefore, MNEs have explored this provision's extent to their advantage so that they could carry on cross-border business activities without triggering the PE status in foreign countries.

The strategy devised by MNEs that we will be addressing is focused on paragraph (f) of article 5 (4) 2014 OECDMC in complement with each of this provision's other paragraphs. This strategy explores a loophole in paragraph (f) that

allows MNEs to take advantage of the exemptions foreseen in each of the other paragraphs of article 5 (4) 2014 OECDMC.

Further to our comments in subsection 1.4.5, article 5 (4) (f) 2014 OECDMC operates as an anti-abuse and anti-splitting provision within this provision, preventing a person from fragmenting a cohesive business operation into several smaller operations. However, this provision has a limited scope since it only applies to fragmentation of activities by the same person, and not to those that involve more persons, leaving a loophole for MNEs to exploit.

Such a limited scope in an anti-abuse provision left significant room for MNEs to actively seek out methods to circumvent it and prevent them from reaching the PE status. Considering MNEs' business models and usual corporate structures, circumventing this limited scope was fairly easy, if the rule does not allow one enterprise to split a business activity into several preparatory or auxiliary activities in different places of business, then simply add enterprises to carry out the different activities and the rule becomes ineffective, leaving an open path to the specific activity exemptions[454].

In this sense, considering the ease with which subsidiaries can be set up, MNEs managed to manipulate the existing loophole to their advantage by strategically fragmenting formerly whole and cohesive business activities amongst several group enterprises, each executing some component of that activity that could be eligible for the specific activity exemptions of article 5 (4) (a) to (e) 2014 OECDMC, but without triggering the aggregator effect of article 5 (4) (f) 2014 OECDMC as the activities are not all carried out by the same enterprise, meaning that all enterprises could reap the benefits of paragraphs (a) to (e)'s exemptions[455].

By fragmenting business activities carried out in the Source Country amongst several group enterprises, each individual enterprise's activities would be analysed under article 5 (4) (a) to (d) 2014 OECDMC, and not the business activities as a cohesive operating business under article 5 (4) (f) 2014 OECDMC, meaning that the

[454] KAROLYI, Balazs – *The Challenges of*… p. 46.
[455] OECD – *Preventing the Artificial*… p. 39; BETTEN, Rijkele; NAOUM, Monia – *Chapter 2: Permanent…* pp. 4-6; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 508; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 308; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 561; PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 445.

PE status' risk would be diluted between all entities and less likely to be achieved, hence less overall taxation for the group[456].

Even if some of the enterprises' activities failed to be eligible for the specific activity exemptions, other group enterprises could still be able to avoid reaching the PE status under article 5 (4) (a) to (d) 2014 OECDMC, hence managing to dilute the group's PE risk and lowering its overall tax burden by reducing exposure to source taxation[457].

As commented in the preceding subsection, there has been a significant technological leap forward in some economic sectors and MNEs' business models. This caused MNEs to adopt more aggressive BEPS strategies by intentionally shifting and modifying their supply chains so that it would fit within article 5 (4) 2014 OECDMC's exemptions[458]. For instance, MNEs would change their local subsidiaries relationship within the group from full-fledged manufacturers, a typical PE, into toll manufacturers for processing of goods held by the foreign MNE, as such, a stock of goods would be exempt under article 5 (4) (c) 2014 OECDMC and paragraph (f) could not be applicable[459].

Nowadays it is fairly easy for MNEs to control their global activity from a specific country and have a limited presence in other countries, which favours the application of this second BEPS strategy's second feature. For instance, a precious gems trader, Company 1, resident in country B, has a branch in country A where it selects and buys raw gems. After buying the gems, they are sent to Company 2, a wholly-owned subsidiary of Company 1 resident in country B, for storage, grading and cleaning, at Company 2's warehouse in country A. Afterwards, Company 2 sends the cleaned gems to its factory in country B for processing and detailing into a finished gem, as per Company 1's specifications. Upon processing, the gems are sent to Company 1's offices in country B where they are packaged and commercialized

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[456] PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 445; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 508; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 561.
[457] BETTEN, Rijkele; NAOUM, Monia – *Chapter 2: Permanent…* pp. 4, 6; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 561.
[458] GILLESPIE, John – *The Base Erosion*… p. 21.
[459] COTRUT, Madalina; AMBAGTSHEER-PAKARINEN, Laura – *Chapter 7: Business Restructurings: The Toolkit for Tackling Abusive International Tax Structures* In COTRUT, Madalina [et. al.] eds. – *International Tax Structures in the BEPS Era: An Analysis of Anti-Abuse Measures*. Books IBFD. 2015. pp. 2-5, 15.

through various channels. This example is also valid for other economic sectors, such as the fabrics and clothing sector or the agricultural sector.

Through the above artificial fragmentation of a cohesive business activity, buying and selling precious gems, neither company would have a PE in country A, significantly diminishing the group's source taxation through this BEPS strategy, since each presence in the said country would benefit from the preparatory or auxiliary activities exemption.

The same goal is achieved for instance in the bulk retail sector, where, for example, Company 5, resident in country Z, manufactures and sells clothing or household appliances at a global level. Company 5 has a warehouse for storage and delivery of its products in country X. Company 6, a wholly-owned subsidiary of Company 5, has a store in country X where it sells Company 5's products. Customers go to Company 6's store and buy products, however, prior to delivery to the client, Company 6 acquires those same products from Company 5 at the warehouse in country X.

Again, Company 5 would not have a PE in country X, as the warehouse would be eligible for article 5 (4) 2014 OECDMC's exemption and the other component of this cohesive business operation is conducted by another enterprise.

The desire for increased profits and lower taxation led MNEs' to take on the loophole left by the OECD in article 5 (4) (f) 2014 OECDMC, the obvious incentive and MNEs' sheer ingenuity brought them to circumvent the restriction on single enterprises activity's fragmentation by purposefully splitting operations using multiple related enterprises, each with a complementary component of a once cohesive business operation that could be entitled to the preparatory or auxiliary activities' exemptions[460].

It is evident that should article 5 (4) (f) 2014 OECDMC apply to the fragmentation of activities amongst multiple enterprises, the aforementioned examples, and others akin, would trigger paragraph (f) and the overall activity carried out in the Source Country would fail the preparatory or auxiliary test and a

[460] BETTEN, Rijkele; NAOUM, Monia – *Chapter 2: Permanent…* p. 4; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 561.

PE would most likely be deemed to exist, therefore, there was a flagrant incentive for MNEs to engage in this BEPS strategy[461].

Furthermore, this practice reveals article 5 (4) (f) 2014 OECDMC's susceptibility to artificial avoidance, it is this anti-abuse provision's limited scope that causes such avoidance practice by allowing MNEs to claim entitlement to the specific activity exemptions, through multiple enterprises, where they are no longer fitting, distorting their original valid purpose[462].

This strategy could occur in all countries regardless of their take on the existence of automatic deeming exemptions, however, it is in the countries that see paragraphs (a) to (d) as automatic deeming provisions that this second feature reaches its zenith, as in that case, the fragmented activities would be automatically exempted and paragraph (f) would still not apply. In other countries, each fragmented activity would still have to overcome the preparatory or auxiliary test, meaning that the PE status' risk is not as low.

At this point, the causes and practices of the second feature of the second BEPS strategy are clear, which goes to stress the relevance of the segregation made concerning this BEPS strategy. Through our explanation, the route to eliminating this avoidance concern is also brighter, as such, we will now present and analyse the amendments and solutions recommended in Action 7 to ascertain whether this route was effectively taken.

2.3.3.2. Amendments and solutions

Having unravelled the causes and practices of the second feature of the second BEPS strategy, we will move onto the amendments and solutions proposed to eradicate such practices and stop the artificial avoidance of PE status through the fragmentation of activities between related enterprises.

It is well-known that this century's technological leaps in economic sectors and MNEs business models have caused a great impact on international taxation and will continue to do so as technology is in constant evolution, so the international taxation

[461] CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509; GILLESPIE, John – *The Base Erosion*… pp. 21-22.
[462] GILLESPIE, John – *The Base Erosion*… p. 21.

system needs to keep on evolving and to refrain malicious practices, such as tax avoidance and abuse.

Even though the second feature's cause is not directly connected with technological progress, it is a fact that MNEs' new business models rely heavily on technology to maintain their global activity, and in this sense, the fragmentation of activities between related enterprises also became easier thanks to it. Notwithstanding, the identified cause of this BEPS practice is unaffected by technology, in the sense that a MNE can take advantage of that loophole regardless of technology since it only requires the ability to set up one, or more, group enterprises to conduct a portion of its business activity.

Neither the cause nor the practice is a novelty, and the OECD should have introduced a solution to this issue sooner. Yet, the OECD seems to have acted now as there is a proposed solution in Action 7.

Following our previous subsection's comments, for some countries the first feature does not raise BEPS-related concerns, instead, this second feature is the true cause for BEPS concerns within article 5 (4) 2014 OECDMC, hence said countries are allowed to only implement the solution presented and analysed herein[463].

We have already made clear our disagreement with this view, as from our standpoint it is obvious that both features raise BEPS concerns and the divergent views of countries in this regard escalates these concerns, being a cause for further mismatches and loopholes.

Furthermore, these practices could occur in all countries regardless of their position on the automatic deeming exemptions' theory, even though it is of greater concern for countries that abide by this theory, it still is a common concern, and a unified, single and comprehensive solution should have been put forward by Action 7.

[463] OECD – *Preventing the Artificial*… p. 28; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 308; PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 445; GILLESPIE, John – *The Base Erosion*… pp. 38-39; BARBIER, Casper – *The Permanent Establishment*… p. 58.

Moreover, the full effect of Action 7's proposed solution for the first feature only arises with its integration with this second feature's solution, since only together may they be effective against the second BEPS strategy[464].

Proceeding into the actual amendments and solutions proposed in Action 7 against these BEPS practices, it is clear that Action 7's recommended path is set on reducing the scope of article 5 (4) OECDMC through the addition of a new provision inspired by article 5 (4) (f) 2014 OECDMC but with a wider scope that negates the benefits of that article by aggregating fragmented business activities that would previously evade article 5 (4) (f) 2014 OECDMC.

The recommended solution in Action 7 against the discussed fragmenting practices focus on the addition of a new fall-back provision within article 5 (4) OECDMC and on key adjustments to the Commentary to assist on its interpretation and application within article 5 (4) OECDMC's context[465].

From our remarks on the causes and practices of this second feature of the second BEPS strategy, it is obvious that the faulty element resides on the limitation of the scope of that anti-abuse provision to fragmentation by a single enterprise, therefore, the route to solve this issue had to be the broadening of that scope, which would lead to a lower PE threshold[466].

Action 7's proposed addition to article 5 (4) OECDMC's wording seems to have taken into consideration this route and presents a provision with a wide scope of application and that would lead to a lower PE threshold:

"*4.1 Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and*

a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or

[464] OECD – *Preventing the Artificial*… p. 39.
[465] OECD – *Preventing the Artificial*… pp. 39-41.
[466] DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 308; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509.

b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,

provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation"[467]

Action 7's recommended solution takes the form of an anti-fragmentation rule, an exception to the exemptions, that negates article 5 (4) OECDMC's benefits where business activities that constitute a cohesive business operation are fragmented by one enterprise, or between multiple closely related enterprises, in the Source Country[468].

This solution seeks to end the artificial fragmentation of business activities that MNEs implemented to avoid PE status in the Source Country through the separate analysis of the fragmented activities and claiming that each one had a preparatory or auxiliary character, hence, with this solution, there is no longer an incentive to fragment such activities[469].

This anti-fragmentation rule takes on inspiration from article 5 (4) (f) 2014 OECDMC's anti-abuse provision from the Commentary and supersedes it by scrapping its limited scope, that was the cause of the BEPS practices addressed above, and by adopting a comprehensively wide scope that covers both the single and multiple related enterprises fragmentation of activities, thus stopping the artificial avoidance strategies designed by MNEs to elude source taxation by aggregating the activities conducted in the Source Country[470].

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[467] OECD – *Preventing the Artificial*… p. 39.
[468] OECD – *Preventing the Artificial*… pp. 39-41; KAROLYI, Balazs – *The Challenges of*… p. 46; GILLESPIE, John – *The Base Erosion*… pp. 30, 33; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 36.
[469] OECD – *Preventing the Artificial*… pp. 39-41; KAROLYI, Balazs – *The Challenges of*… p. 46; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509; WETTERSTEN, Maria – *How can the*… pp. 19-20; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 34.
[470] OECD – *Preventing the Artificial*… pp. 39-40; AMORIM, Ana Teresa Machado Rodriguez – *Ação 7 do*… pp. 42-43; WETTERSTEN, Maria – *How can the*… pp. 19-20, 26.

It is noteworthy that, Action 7 opted to promote the anti-fragmentation provision from the Commentary to article 5 (4) OECDMC's wording itself, as well as refining it up to a state where it could be effective against the practices it once undesirably allowed[471]. This intended shift from the Commentary to the wording carries significant importance in the interpretation and application of this provision, as well as it demonstrates a greater concern from the OECD with these practices and the intent to give this provision added weight in the international taxation system.

Through Action 7's proposed article 5 (4) (1) OECDMC, the exemptions of each of the paragraphs of the said provision would be denied if the qualifying activity resulted from the splitting of a cohesive business operation by a single enterprise, or between multiple closely related enterprises, into several activities that constitute complementary functions within that split business[472].

Also, despite the unfortunate wording of the proposed anti-fragmentation rule, its scope should not be understood as being limited to situations including only two enterprises or two locations, otherwise, such rule would be pointless considering the causes and practices of this second BEPS strategy's second feature[473].

In fact, the anti-fragmentation rule deploys a dual approach against the commented anti-fragmentation issues through two different subparagraphs, each addressing a specific practice and BEPS concern in this context. In subparagraph (a), the proposed rule targets fragmentation practices where the enterprise, or a closely related enterprise, already has a place that constitutes a PE in the Source Country.

This subparagraph would deny the benefits of article 5 (4) OECDMC if an enterprise carries on activities in a FPOB in the Source Country and the same enterprise, or a closely related enterprise, carries on other activities at that same place, or at another place, in the Source Country, and either place constitutes a PE of the enterprise, or the closely related enterprise, provided that the business activities are complementary and part of a cohesive business operation[474].

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[471] OECD – *Preventing the Artificial*… pp. 39-41; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 308; GILLESPIE, John – *The Base Erosion*… p. 34.
[472] OECD – *Preventing the Artificial*… p. 39; KAROLYI, Balazs – *The Challenges of*… p. 46; GILLESPIE, John – *The Base Erosion*… pp. 30, 33-34; WETTERSTEN, Maria – *How can the*… p. 19-20.
[473] GILLESPIE, John – *The Base Erosion*… p. 34.
[474] OECD – *Preventing the Artificial*… pp. 39-41; GARBARINO, Carlo – *Permanent Establishments and*… p. 372; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509.

To put it into an illustrative example, subparagraph (a) targets cases such as the aforementioned bulk retail sector's example or the one regarding toll manufacturers. As mentioned, Company 5 has a warehouse in country X, excluded from the PE status under article 5 (4) 2014 OECDMC, and Company 6 has a store and is resident in country X. So, no PE for Company 5.

However, under Action 7's recommended provision, Company 5 would not be entitled to article 5 (4) OECDMC's benefits, since the activities carried out in country X are clearly complementary functions and part of a cohesive business operation and the store constitutes a *de facto* PE of Company 6, even though it is a resident enterprise[475].

On this point, Action 7 introduces an important remark on the recommended Commentary to this rule's application by clarifying that the PE concept is not limited to cross-border situations, it also applies to domestic situations, such as the one in our example concerning Company 6, meaning that even though an enterprise is resident in a country it continues to be relevant under the PE concept[476].

Therefore, the benefits of article 5 (4) OECDMC would be denied to Company 5 and it would be deemed to have a PE in country X resulting from the activities carried out therein together with the presence of a resident related enterprise, rendering useless the fragmentation strategy implemented.

The other approach in Action 7's recommended anti-fragmentation rule is present in subparagraph (b) and focuses on cases where, individually, the activities carried out in the Source Country would benefit from article 5 (4) OECDMC's exemptions, but together, the overall activity fails the preparatory or auxiliary test and each activity is complementary and part of a cohesive business operation[477].

The proposed subparagraph (b) is similar to article 5 (4) (f) OECDMC, but with a considerably larger scope, as it also engulfs situations involving multiple closely

[475] OECD – *Preventing the Artificial*… pp. 39-41; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 131.
[476] OECD – *Preventing the Artificial*… p. 41; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 130.
[477] OECD – *Preventing the Artificial*… pp. 39-40; GARBARINO, Carlo – *Permanent Establishments and*… p. 372.

related enterprises carrying on activities at the same place of business, or a single or multiple closely related enterprises carrying on activities at multiple locations[478].

To assist in subparagraphs (a) and (b)'s interpretation, Action 7 also recommends amendments to the Commentary that would bring further guidance on the application of this new rule, including examples, albeit slim[479].

In this sense, the abovementioned illustration of the precious gems trader can be enlightening as to the application of subparagraph (b), since Company 2 (the gems' cleaner and processor) would be denied entitlement to article 5 (4) OECDMC's exemptions according to the proposed anti-fragmentation rule. With effect, its core business activity is the processing and detailing of gems as per the specifications received and, for this business activity, the selection and buying of gems together with its grading and cleaning constitute complementary functions that are part of a cohesive business operation and those activities are carried out by closely related enterprises.

Therefore, Company 2 would no longer be able to avoid the PE status, which would consequently raise the same concern for Company 1, given that subparagraph (a) could apply as one of the places of business would constitute a PE.

2.3.3.3. Analysis

As per our explanation above, the proposed anti-fragmentation rule would be able to maintain the same efficacy and accuracy it had against single enterprise fragmentation strategies in the newly included multiple closely related enterprises' strategies.

Instead of completely reformulating article 5 (4) OECDMC, Action 7's recommendation consists on the introduction of a backstop provision that maintains the purpose of the preparatory or auxiliary activities' exemptions and recovers its true application to enterprises engaged in cross-border ventures, without being vulnerable to circumvention by MNEs or leading to the artificial

[478] OECD – *Preventing the Artificial*... pp. 39-40.
[479] OECD – *Preventing the Artificial*... pp. 40-41.

avoidance of PE status[480]. The preparatory or auxiliary activities' exemptions are needed in the international taxation system and essential in our global trade economy, reason why this protection of their value is required.

This proposed anti-abuse provision would effectively prevent the artificial fragmentation of activities by MNEs, cohesive business operations would no longer be allocated to different group enterprises to lower the tax burden and PE risk[481]. The anti-fragmentation rule seeks to negate the benefits abusively sought by MNEs and restore the taxation due, absent avoidance practices, but somewhat refrained, as it does not aggregate every activity, instead, it is limited to those that are complementary and part of a cohesive business operation[482].

By creating this fail-safe provision that denies the exclusion from the PE status to those activities, Action 7 is actively and considerably lowering the PE concept's threshold by adding additional layers that need to be surpassed, *i.e.* another test (on top of the proposed universal preparatory or auxiliary test) and one almost impossible to beat for MNEs that implemented this second BEPS strategy's practices[483].

A lower PE threshold entails for MNEs a higher PE risk and a greater concern over the activities that a group has in a country[484]. Under this anti-fragmentation rule, the holistic analysis and approach demanded by article 5 (4) (f) 2014 OECDMC are amplified and MNEs will have to have a greater notion of the synergies and relationships between all related enterprises and activities in source countries[485].

Even though the direct purpose of this solution is not to trigger more PEs across source countries, the consequence of its application will definitely lead to that outcome, since by negating the exemptions of article 5 (4) OECDMC, article 5 (4) (1)

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[480] GILLESPIE, John – *The Base Erosion*… p. 33; GARBARINO, Carlo – *Permanent Establishments and*… p. 372.
[481] CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509; WETTERSTEN, Maria – *How can the*… pp. 25-26.
[482] GILLESPIE, John – *The Base Erosion*… p. 33; GARBARINO, Carlo – *Permanent Establishments and*… p. 372.
[483] CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509; WETTERSTEN, Maria – *How can the*… pp. 20, 25-26.
[484] CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509; GILLESPIE, John – *The Base Erosion*… pp. 34-35.
[485] GARBARINO, Carlo – *Permanent Establishments and*… p. 372; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509; GILLESPIE, John – *The Base Erosion*… pp. 34-35; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 36.

OECDMC is inadvertently creating a PE, considering that article 5 (4) OECDMC only applies where article 5 (1) OECDMC's threshold has been exceeded[486].

Considering the causes and practices showcased and our explanation of this anti-fragmentation rule, our view is that the two-pronged approach and wider scope proposed in Action 7 would be adequate to render futile anti-fragmentation practices and successfully prevent the artificial avoidance of PE status through such strategies.

Also, the aggregator effect of this anti-abuse provision on MNEs' fragmented complementary activities honours article 5 OECDMC's purpose, which is to provide taxing rights to the Source Country over the business profits of foreign entities significantly engaged therein, regardless of the abusive practices put in place to avoid the PE status[487]. It is rational, and effective against these BEPS practices, to combine separate activities that are dependent on each other and form part of an intrinsically connected business, even with multiple related enterprises[488].

Action 7's projected route to combat the fragmentation practices commented seems to have satisfactorily addressed its main objective, *i.e.* to prevent the practices exposed above, where each of the fragmented activities carried out by closely related enterprises could be entitled to article 5 (4) 2014 OECDMC's exemptions, and to keep on preventing single enterprises fragmentation practices by aggregating those activities[489].

Although it is our understanding that this anti-fragmentation provision should be praised for its innovative take on this troublesome practice by MNEs and its apparent effectiveness against them, several aspects within it are in dire need of improvement and it would be vital to address these issues before implementation, as otherwise, disputes and debates will emerge, damaging its outcome.

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[486] CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509; GILLESPIE, John – *The Base Erosion*… pp. 34-35; JIMÉNEZ, Adolfo J. Martín – *The Spanish Position*… p. 470; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 36.

[487] PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 445; GILLESPIE, John – *The Base Erosion*… p. 33; WETTERSTEN, Maria – *How can the*… pp. 25-26.

[488] PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 445; GILLESPIE, John – *The Base Erosion*… p. 33.

[489] OECD – *Preventing the Artificial*… pp. 39-40; WETTERSTEN, Maria – *How can the*… pp. 25-26; GARBARINO, Carlo – *Permanent Establishments and*… p. 372; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 561.

Some of these issues were already addressed in the preceding subsection as they are common concerns in Action 7's solution against the second BEPS strategy, such as the increased administrative and tax burdens over taxpayers and tax administrations, and the stronger presence of economic analysis in article 5 (4) OECDMC. Therefore, we refer to our comments above in this regard.

In this context, we highlight that the anti-fragmentation rule proposed by Action 7 evolved from the Commentary to the wording, yet, through such a process, it failed to shed the issues it already had when it was there. Succinctly, those issues are essentially the lack of depth and guidance provided for the interpretation of the new key concepts introduced, the "complementary functions" and the "cohesive business operation" concepts.

Following our explanation, there is no doubt that both concepts are vital in the interpretation and application of article 5 (4) (1) OECDMC. However, neither its wording nor its Commentary provides a definition for these concepts or even a glimpse of guidance on their interpretation, other than two specific examples[490].

The notions of "complementary functions" and "cohesive business operation" are fundamental to this provision and Action 7's solution does not provide any element for the interpreter to grasp the extent and limitations intended for these provisions other than their wording and the examples, such as how complementary should the activities be, should dependency be a factor; or how cohesive should an operation be, how integrated should they be[491]. These concepts bear an intrinsic quantitative nature that needs to be measured and Action 7 provides no clear indication on it, this absence leads to increased subjectivity in the interpretation of the concepts and possibly divergent practices[492].

Legal certainty on the interpretation of these concepts, and of the provision itself, is crippled since this solution leaves more questions than answers, thus a rise in debates and disputes between taxpayers, tax administrations and courts is expected[493].

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[490] BARBIER, Casper – *The Permanent Establishment*… p. 60; GILLESPIE, John – *The Base Erosion*… pp. 32-33, 44-45, 48-50.
[491] GILLESPIE, John – *The Base Erosion*… pp. 32-33, 44-45, 48-50.
[492] GILLESPIE, John – *The Base Erosion*… pp. 49-50.
[493] GILLESPIE, John – *The Base Erosion*… pp. 44-45.

On this matter, we favour a stance that relies on a case-by-case approach and that ponders the particularities of each economic sector[494]. Nonetheless, clear comprehensive guidance on these concepts is crucial for this solution to reach an acceptable outcome.

The absence of proper guidance on a fresh provision that introduces new concepts reveals Action 7's lack of vision to anticipate problems that may arise from the application of such concepts, evidencing an inability to learn from the past to improve the future, which is highly regrettable considering the extent of the issues at hand.

Furthermore, not only is it necessary to include a definition for both concepts and further explanatory guidance on their interpretation and application, but the anti-fragmentation rule itself also requires additional guidance to the one provided, which is dreadfully scarce[495]. For instance, additional guidance could clarify the point made regarding the suggested article 5 (4) (1) OECDMC's unfortunate wording and the inclusion in its scope of more than two enterprises/places, or even the application of this provision to each enterprise of the group of related enterprises and places of business caught in its scope[496].

In this latter issue, our understanding is that the anti-fragmentation rule applies individually to each enterprise that meets the threshold of article 5 (1) OECDMC and would be eligible for article 5 (4) OECDMC's exemptions was is not for the application of that rule. We do not adhere to the theories of a "group PE" or "main enterprise PE" arising from this rule as it is not a deeming provision and neither Action 7 nor article 5 OECDMC provides any indication for such a deep revision of the PE's principles, in fact, Action 7 advocates the opposite; also, there would be significant complexity arising from either theory from a practical standpoint, regardless, we stress the need to bring clarity and guidance to this provision[497].

Also, an important cause for concern arises from the fact that Action 7's solution may have an exaggerated scope, leading to undesirable spillover effects in relation

[494] BARBIER, Casper – *The Permanent Establishment*… p. 60.
[495] GILLESPIE, John – *The Base Erosion*… pp. 44-45; JIMÉNEZ, Adolfo J. Martín – *The Spanish Position*… pp. 469-470.
[496] DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 561; GILLESPIE, John – *The Base Erosion*… pp. 50-51.
[497] *Ibid*.

to the anti-fragmentation rule. As stated, this provision's application is limited to activities that are complementary and part of a cohesive business, however, this only leads to a false sense of refrainment from this provision, as it could effectively aggregate all of those activities, regardless of the sound and genuine reasons that lead to the attribution of certain activities to other enterprises, absent tax considerations[498].

This aspect would distort the purpose of Action 7's solution by going beyond what is truly artificially, therefore, the anti-fragmentation rule should be amended to focus its scope on artificial practices, which is Action 7's actual purpose[499]. Regrettably, undesired spillover effects are plentiful within Action 7's proposed solutions and measures.

Even though a significant rise in the recognition of PEs, and therefore source taxation, is expectable, and even welcomed, this surge should be caused by the adequate targeting of abusive and artificial structures and practices, as originally intended, and not by a blind catch-all provision, which may encourage countries to go beyond it[500]. Such provision may even lead to damaging economic effects, which is contrary to OECD's main purpose, as it may limit the persons' ability to explore additional markets and businesses by building upon the ones they already have and benefiting from their own synergies[501].

As stressed, there are several ramifications in the practices connected with the second BEPS strategy's second feature, however, even though it is not feasible to expose all practices, two mere examples of specific situations are not enough to bring clarity and legal certainty to this provision's extent. Should this solution be implemented as is, we anticipate an escalation in disputes between MNEs and tax administrations regarding this provision's application, and disputes between practitioners and scholars, potentially leading to dreadful divergent country practices.

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[498] GILLESPIE, John – *The Base Erosion*… pp. 34, 45-46; WETTERSTEN, Maria – *How can the*… p. 28; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 128.
[499] GILLESPIE, John – *The Base Erosion*… pp. 45-46; WETTERSTEN, Maria – *How can the*… p. 28; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 128.
[500] AHMED, Muhammad Ashfaq – *Pakistan: Bracing for BEPS*. Intertax. Volume 48, issue 3 (2020) pp. 338-339.
[501] GILLESPIE, John – *The Base Erosion*… pp. 45-47; WETTERSTEN, Maria – *How can the*… pp. 27-28.

From our analysis, we find that only after improving the solution presented in Action 7 with the adjustments abovementioned, could this provision be an effective tool in preventing the artificial avoidance of PE status, should those adjustments not be made, we fear that Action 7's solution will not be as effective and will be a cause of concern and uncertainty[502].

Now it is clear that the anti-fragmentation rule is a logical consequence of the removal of the automatic deeming exemptions of article 5 (4) 2014 OECDMC, as together they would both lower the PE's threshold, the first by expanding its scope of application and the second by limiting its scope, and lead to a substantial increase in the recognition of PEs by purging the second BEPS strategy[503].

As a whole, and despite some need for improvement before implementation, the proposed solution against the second BEPS strategy could be an effective method to eradicate the artificial avoidance of PE status through article 5 (4) OECDMC, and it strikes us as one that could be most effective, perhaps even disproportionate.

Both solutions reach their full potential when combined in a single provision, isolated they would still be effective, although not at the same level, and would be prone to some of the BEPS practices showcased, contrary to Action 7's purpose.

Nevertheless, a cause for great concern, customary throughout this Chapter, is the lake of unity, coordination and cooperation in the amendments and solutions Action 7 proposes vis-à-vis the causes and practices commented. The merits of Action 7's desired solutions are severely undermined by the freedom given to countries on the implementation of the solutions against the second BEPS strategy.

Following the above, our analysis of Action 7's imperfect solution against this second BEPS strategy's second feature is concluded, as well as our analysis on the complete second BEPS strategy. This solution's different elements and dimensions have been exposed in our analysis, as have the merits of the anti-fragmentation rule and the issues related with its application and interpretation. The overall assessment of this solution is of an acceptable first draft that still is jagged and in need of refinement.

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[502] GILLESPIE, John – *The Base Erosion*… p. 36.
[503] OECD – *Preventing the Artificial*… p. 39; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 308; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 509.

From the second BEPS strategy, we move into the last BEPS strategy identified in Action 7, which is connected with the DAPE concept and is one of Action 7's most relevant features, and the one with the most significant proposed modifications.

2.3.4. Article 5 (5) 2014 OECDMC – DAPE and commissionaire arrangements

Having addressed the first and second BEPS strategy, we advance to Action 7's third, and final, BEPS strategy and the proposed course of action against it. This third BEPS strategy is centred on the artificial avoidance of PE status through the DAPE concept.

Herein we also separate this BEPS strategy into two different features, each connected with its specific causes and practices, and solutions. The first feature relates to article 5 (5) 2014 OECDMC and the interpretation of the DAPE concept, and the second feature's core issue lies on the independent agent status of article 5 (6) 2014 OECDMC.

We commence with the first feature of the third BEPS strategy, starting with the presentation and explanation of its causes and practices, and afterwards of the amendments and solutions recommended by Action 7 to prevent and remove them.

2.3.4.1. Causes and practices

Following the above, this third BEPS strategy's first feature 7 exploits the DAPE concept's loopholes so that MNEs may artificially avoid this status[504]. MNEs implementing this strategy essentially target article 5 (5) 2014 OECDMC, with some influence from article 5 (6) 2014 OECDMC, to reach their goal of no PE in source countries and lower overall taxation, while still maintaining their cross-border operations[505].

[504] OECD – *Preventing the Artificial*… pp. 15-16.
[505] *Ibid*.

Specifically, this first feature comprises the use of commissionaire arrangements, commented on in Chapter 1, and similar strategies, with the first being Action 7's main target due to its proliferation[506].

Further to our comments in Chapter 1, a dependent agent is a non-independent person that habitually exercises contracting authority on behalf of and in the name of the principal in the Source Country. As explained therein, "binding" is one of the key elements in the DAPE concept and there are different approaches to that element between stakeholders, especially between Civil Law and Common Law countries.

Despite the lack of consensus regarding this element's interpretation, our understanding is that "binding" should be understood as being legally binding, in the sense that the agent's contracting activities with third parties are legally binding towards the principal, not in an economic fashion and without resorting to a substance-over-form approach.

As stated, our view follows the traditional legal approach of Civil Law countries based on the different types of mandates foreseen in this legal system, mandate with and without representation (*i.e.*, direct and indirect representation), and also that an extensive interpretation should be used in relation to the conclusion of contracts in the Source Country, meaning that this criterion would be fulfilled even where the contracts are finalised or decided in the Residence Country but the vast majority of its aspects were negotiated in the Source Country.

Furthermore, we adhere to the integration theory regarding the relationship between article 5 (5) and (6) 2014 OECDMC, meaning that there is a proper order to assess the existence of a DAPE in the Source Country, under which, first it should be determined whether or not the relevant agent has an independent status, and only where this criterion is fulfilled (*i.e.*, the agent is not independent), does the assessment proceeds to the other criteria of article 5 (5) 2014 OECDMC.

In this context, it is clear that in countries that follow our understanding, commissionaire arrangements and similar strategies would only give rise to a DAPE therein where they acted outside the ordinary course of their business since a

[506] *Ibid*; PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 444.

general commission agent and a broker are automatically deemed to be agents of independent status in article 5 (6) 2014 OECDMC, beyond any analysis.

Action 7 appears to take a stance similar to ours regarding the interpretation of "binding" since it specifically targets commissionaire arrangements as the leading cause for BEPS concerns in this regard, should it follow an economic view, avoidance practices through commissionaire arrangements would not be a concern[507].

In this context, it is important to stress that commissionaire arrangements and similar strategies are essentially a Civil Law countries' BEPS concern, since for Common Law countries a general commission agent or a broker still legally binds the principal when exercising its contracting authority, due to the lack of indirect representation in those countries, as opposed to Civil Law countries[508].

It is not surprising to verify that MNEs learned the existing mismatches and loopholes on the DAPE and exploited them for their behalf, avoiding such status, and taxation, in source countries[509]. In fact, MNEs have been abusively taking advantage of these loopholes for some time, unfortunately, accompanied by inertia from the OECD to prevent such practices[510].

Conscious of the flaws in the DAPE concept, MNEs were able to pinpoint article 5 (5) and (6) 2014 OECDMC's stress points, which, regarding this first feature, have been identified as the divergent interpretation of the "in the name of" criterion (the "binding" element) of this concept and the conclusion of contracts outside the Source Country (although we take the view of an extensive interpretation herein)[511].

MNEs worked around these stress points to avoid PE status while maintaining a similar level of economic presence in source countries, distorting and avoiding

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[507] OECD – *Preventing the Artificial*… p. 15.
[508] EISENBEISS, Justus – *BEPS Action 7…* p. 485; KAROLYI, Balazs – *The Challenges of*… pp. 36-37; MEHTA, Amar – *Chapter 4: The*… p. 4; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 504; HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 26; GARBARINO, Carlo – *Permanent Establishments and*… p. 376; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 24-25.
[509] OECD – *Preventing the Artificial*… p. 15; KAROLYI, Balazs – *The Challenges of*… pp. 36-37; MEHTA, Amar – *Chapter 4: The*… p. 4; EISENBEISS, Justus – *BEPS Action 7…* p. 485.
[510] COTRUT, Madalina; AMBAGTSHEER-PAKARINEN, Laura – *Chapter 7: Business*… pp. 2, 6-8; HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 26.
[511] OECD – *Preventing the Artificial*… p. 15; TRACANA, Dinis –*The Effect of*… p. 214; EISENBEISS, Justus – *BEPS Action 7…* pp. 485-486; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 32.

article 5 (5) and (6) 2014 OECDMC's purpose[512]. To reach their ultimate goal, MNEs adapted and restructured their business structures around those stress points, by using arrangements under which an agent's contracting activity was not legally binding towards them and by retaining the decision to contract at the Residence Country[513].

Commissionaire arrangements, essentially a Civil Law concept, were the principal method chosen by MNEs, considering it gave them the ability to restructure existing business models with relative ease or to implement new, simple(r), business models under this arrangement, without triggering DAPE status[514]. As such, upon homing in on the causes of the third strategy's first feature, we address commissionaire arrangements and the concrete practices put in place by MNEs through these arrangements, and similar ones.

With effect, commissionaire arrangements are a typical example of indirect representation, under which the agent exercises its contracting authority in its own name but on behalf of the principal, which is usually undisclosed, and the contracts the agent concludes with third parties are only legally binding on the agent, not on the principal, albeit the object of the concluded contracts (products, services…) is owned by that principal[515]. In a common MNE environment, the principal and the agent are group enterprises, and often the agent is a subsidiary of the principal.

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[512] OECD – *Preventing the Artificial*… p. 15; LIEBMAN, Howard M. – *Chapter 11: Base*… p. 6; SHTROMBERG, Alexandra – *Managing Permanent Establishment*… p. 54; LANKHORST, Paul; VAN DAM, Harmen – *Post-BEPS Tax Advisory*… p. 67.

[513] OECD – *Preventing the Artificial*… p. 15; KAROLYI, Balazs – *The Challenges of*… pp. 36-37; COTRUT, Madalina; AMBAGTSHEER-PAKARINEN, Laura – *Chapter 7: Business*… pp. 7-8, 15-16; SHTROMBERG, Alexandra – *Managing Permanent Establishment*… pp. 53-54; LANKHORST, Paul; VAN DAM, Harmen – *Post-BEPS Tax Advisory*… p. 67.

[514] OECD – *Preventing the Artificial*… p. 15; LIEBMAN, Howard M. – *Chapter 11: Base*… p. 6; MEHTA, Amar – *Chapter 4: The*… p. 4; KAROLYI, Balazs – *The Challenges of*… pp. 36-37; COTRUT, Madalina; AMBAGTSHEER-PAKARINEN, Laura – *Chapter 7: Business*… pp. 7-8; EISENBEISS, Justus – *BEPS Action 7…* pp. 483-485; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 561; GARBARINO, Carlo – *Permanent Establishments and*… p. 376; SHTROMBERG, Alexandra – *Managing Permanent Establishment*… p. 54.

[515] OECD – *Preventing the Artificial*… p. 15; LIEBMAN, Howard M. – *Chapter 11: Base*… p. 6; MEHTA, Amar – *Chapter 4: The*… p. 4; COTRUT, Madalina; AMBAGTSHEER-PAKARINEN, Laura – *Chapter 7: Business*… pp. 7-8; EISENBEISS, Justus – *BEPS Action 7…* pp. 483-485; KAROLYI, Balazs – *The Challenges of*… pp. 36-37; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 559; GARBARINO, Carlo – *Permanent Establishments and*… p. 376; SHTROMBERG, Alexandra – *Managing Permanent Establishment*… p. 53; HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 28-29; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 15; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 32.

Commissionaire arrangements have two distinct sets of contracts to regulate their implementation, the main contract is between the principal and the agent, whereby the agent will conclude contacts with third parties for the principal's products/services, in its own name but on behalf of the principal, which is the one that will effectively supply the products/services to clients, without the agent ever acquiring said products/services from the principal[516]. Under this contract, the agent is entitled to a remuneration, usually, a commission linked to the number of contracts concluded[517].

The other contract is entered into between the agent and the third party customer, who is generally oblivious of the principal's existence, for the supply of the products/services, being the agent bound before the customer for the fulfilment of the contract, even though it will be effectively fulfilled by the principal, which is the one entitled to the profits resulting from the concluded contracts[518].

The principal is only legally bound in the contract with the agent, and not in the second one with clients, where the sales actually occur, as such, there is no direct legal relationship between client and principal, thus MNEs could prevent article 5 (5) 2014 OECDMC's application since the criteria for its application are not verified because the agent does not legally bind the principal[519].

In this sense, the Source Country will only have taxing rights over the commission paid to the agent, as the profits are shifted to the principal's country because the DAPE's threshold is not exceeded and the products/services are of the principal, meaning that the Source Country does not have taxing rights over these profits and that the principal can avoid PE status and taxation therein[520]. Even

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[516] MEHTA, Amar – *Chapter 4: The*… p. 4; COTRUT, Madalina; AMBAGTSHEER-PAKARINEN, Laura – *Chapter 7: Business*… pp. 7, 15; KAROLYI, Balazs – *The Challenges of*… p. 36; EISENBEISS, Justus – *BEPS Action 7…* pp. 483-485; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 15; HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 28-29.

[517] LIEBMAN, Howard M. – *Chapter 11: Base*… p. 6; KAROLYI, Balazs – *The Challenges of*… p. 36; EISENBEISS, Justus – *BEPS Action 7…* p. 483; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 559; HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 29.

[518] MEHTA, Amar – *Chapter 4: The*… p. 4; EISENBEISS, Justus – *BEPS Action 7…* pp. 483-484; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 15.

[519] MEHTA, Amar – *Chapter 4: The*… p. 4; COTRUT, Madalina; AMBAGTSHEER-PAKARINEN, Laura – *Chapter 7: Business*… pp. 7, 16; KAROLYI, Balazs – *The Challenges of*… pp. 36-37; EISENBEISS, Justus – *BEPS Action 7…* p. 485; GARBARINO, Carlo – *Permanent Establishments and*… p. 376; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 559.

[520] LIEBMAN, Howard M. – *Chapter 11: Base*… p. 6; OECD – *Preventing the Artificial*… p. 15; COTRUT, Madalina; AMBAGTSHEER-PAKARINEN, Laura – *Chapter 7: Business*… p. 16; KAROLYI, Balazs – *The Challenges of*… pp. 36-37; EISENBEISS, Justus – *BEPS Action 7…* pp. 484-485; DE WILDE, Maarten

though the Source Country may tax the commission paid to the agent, such amount is only a fraction of the effective sales profits that occurred therein, meaning that the Source Country suffers a significant erosion of its taxable base and tax revenue[521].

Additionally, by adapting this strategy, MNEs have also found effective methods to avoid PE status in Common Law countries through synthetic commissionaires, under which the contracts concluded between agent and clients expressly state that the agent does not bind the principal[522]. Henceforth, both commissionaire and synthetic commissionaire arrangements will be addressed without distinction.

As commented, not only did MNEs implemented these arrangements *ab initio* in their cross-border endeavours in different countries, but, aware of the tax minimization potential of these arrangements, they reorganised already existing structures to capitalize on the existing loophole. For instance, MNEs would shift their subsidiaries from existing buy-sell arrangements (*e.g.*, full-fledged distributors) to commissionaire arrangements, under which MNEs would absorb their local subsidiaries' business (stocks, clients base…), and those in return would agree to sell in their country the MNEs' products/services, in their own name but on behalf of the MNEs[523].

To put in practice, take the following example: Company T, resident in country T, is a manufacturer of orthopaedic products and has a subsidiary, Company U, resident in country U, that sells in that country the products manufactured by its parent. Company U acquires the products from its parent and then sells them in its store in country U. Company U is subject to taxation in country U over the profits it makes from selling orthopaedic products and bears the typical risks associated with

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Floris – *Lowering the Permanent*… p. 559; HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 29; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 32.

[521] LIEBMAN, Howard M. – *Chapter 11: Base*… p. 6; OECD – *Preventing the Artificial*… p. 15; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 559; HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 29; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 32.

[522] EISENBEISS, Justus – *BEPS Action 7…* p. 486; HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 26.

[523] OECD – *Preventing the Artificial*… p. 15; MEHTA, Amar – *Chapter 4: The*… p. 4; COTRUT, Madalina; AMBAGTSHEER-PAKARINEN, Laura – *Chapter 7: Business*… pp. 7-8; KAROLYI, Balazs – *The Challenges of*… pp. 35-36; GARBARINO, Carlo – *Permanent Establishments and*… p. 377; SHTROMBERG, Alexandra – *Managing Permanent Establishment*… pp. 53-54; HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 29-30; LANKHORST, Paul; VAN DAM, Harmen – *Post-BEPS Tax Advisory*… p. 67.

a business activity, also, Company T is subject to taxation in country T over the profits it makes when selling to Company U.

Company T decides to restructure its business activity by adopting a commissionaire arrangement. Company T acquires Company U's fixed assets, stocks and clients base and concludes a commissionaire agreement, under which Company U will sell its parent's products in country U, in its own name but on behalf of the parent, and receive a 5% commission for each product sold at market value. Through this shift, country U will only be able to tax the 5% commission paid to Company U, since Company T's profits from sales will only be subject to taxation in country T given that it will not achieve PE status in country U and the products are Company T's, also, Company U will only bear limited risks, such as marketing and sales, which connect with its activity.

Through this shift, Company T managed to reduce significantly the group's overall taxation, as it diminished Company U's taxation in the Source Country (limited to the commission) and avoided reaching PE status therein, while maintaining the same level of economic presence in country U, and possibly the same level of sales, which could mean higher overall profits considering the lower source taxation[524].

As per the above example, it is fairly easy for MNEs to restructure their existing business models into commissionaire arrangements, as they already have a group company in the target country that is familiar with conducting business therein and a client base to maintain their business, therefore, only the execution of the proper agreements is required[525].

With effect, through these practices MNEs could prevent PE status in source countries because they would not surpass article 5 (5) 2014 OECDMC's threshold, as they rested on the interpretation of the "binding" concept as the agent legally binding the principal in the contracts concluded with clients, which does not occur, while maintaining the same local economic presence as they did under other traditional arrangements. As a result, since there is no DAPE and the agent does not

[524] OECD – *Preventing the Artificial*… p. 15; KAROLYI, Balazs – *The Challenges of*… pp. 35-37; SHTROMBERG, Alexandra – *Managing Permanent Establishment*… p. 54; HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 29-30.
[525] KAROLYI, Balazs – *The Challenges of*… p. 37; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 559.

own the products/services sold, the profits arising from such sales would go untaxed in source countries, leaving just the commission paid to the agent[526].

This becomes even more relevant where the Source Country is a high-taxation country, as typical, as opposed to the typical low-taxation Residence Country, thus MNEs could effectively shed a significant portion of their overall taxation through these arrangements since only the less significant commission would be subject to higher taxation leaving the substantial profits subject to lower taxation[527].

Besides, the practices of this first feature are not exclusively connected with commissionaire arrangements, it includes similar strategies as well, for instance, synthetic commissionaire arrangements. There still are other relevant similar strategies, such as marketing services companies arrangements and others, under which the contracts are substantially negotiated in the Source Country by an agent, for example as marketing and sales support services to the MNE, but the contract's final stage and decision are shifted to the MNE in the Residence Country, therefore the contracts are not effectively concluded in the Source Country[528].

As ascertained, MNEs can fairly easy modify their business models to adopt a commissionaire arrangement, but it is even easier for them to artificially shift the location of the conclusion of a contract, thus avoiding DAPE status in the Source Country[529]. Again, only a residual commission is left in the Source Country for taxation since the agent does not exercise a contracting authority in the name and on behalf of the principal therein[530]. Notwithstanding, under our extensive interpretation view, these practices are of limited BEPS relevance.

These practices could evidently originate BEPS concerns, as they exploit article 5 (5) and (6) 2014 OECDMC's fragilities, in fact, Action 7 clearly addresses them as strategies primarily implemented for BEPS purposes, however, such a broad statement may give rise to adverse spillover effects, such as claiming that all

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[526] DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 559; LIEBMAN, Howard M. – *Chapter 11: Base*… p. 6; OECD – *Preventing the Artificial*… p. 15; LANKHORST, Paul; VAN DAM, Harmen – *Post-BEPS Tax Advisory*… p. 67.
[527] LIEBMAN, Howard M. – *Chapter 11: Base*… p. 6; SHTROMBERG, Alexandra – *Managing Permanent Establishment*… p. 53; HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 28-29.
[528] OECD – *Preventing the Artificial*… p. 15; EISENBEISS, Justus – *BEPS Action 7…* pp. 485-486; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 505; TRACANA, Dinis –*The Effect of*… p. 215.
[529] KAROLYI, Balazs – *The Challenges of*… pp. 42-43.
[530] EISENBEISS, Justus – *BEPS Action 7…* p. 486.

commissionaire and similar arrangements are artificial and implemented for BEPS motives, reason why refrainment would be advisable as there could be genuine reasons to implement such arrangements[531]. While Action 7 makes such a bold and broad statement, it also evidences caution by expressly excluding LRD arrangements from its scope, shifting the concern to Action 9[532].

Following the above, we demonstrated the intricate causes and practices of the third BEPS strategy's first feature to artificial avoid PE status, which are closely connected with both the wording and Commentary of article 5 (5) 2014 OECDMC and their divergent interpretation by countries, relying on the interpretation of "binding" as legally binding upon the principal and putting in place arrangements that remove such possibility, and the shift out of the Source Country of the final process of contract conclusion, even though the majority of the contract was negotiated there, to claim they were not effectively concluded therein.

In a nutshell, MNEs were successfully eluding DAPE status by taking advantage of article 5 (5) 2014 OECDMC's loopholes, therefore, to prevent these practices and eliminate their cause, substantial changes were needed.

At this stage, having presented this strategy's source, we advance onto the solutions proposed by Action 7 to eradicate these practices and prevent the artificial avoidance of DAPE status.

2.3.4.2. Amendments and solutions

Upon concluding the explanation of the causes and practices of this third BEPS strategy's first feature, it is clear that an overhaul to article 5 (5) 2014 OECDMC is required to prevent such practices, not only to the wording but also to its Commentary, as both are a cause of BEPS concern[533]. The amendments and solutions proposed by Action 7 are presented next to assess if such an objective is achievable.

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[531] OECD – *Preventing the Artificial*… p. 15; HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 30-34; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 35-36.
[532] OECD – *Preventing the Artificial*… pp. 15-16.
[533] OECD – *Preventing the Artificial*… p. 15.

As evidenced thus far, Action 7 has tried to accommodate different views and understandings on the BEPS' causes and practices perilous situation, often providing multiple optional solutions to the issues identified and allowing countries to cherry-pick them, which in our view leads to greater uncertainty and possibilities for MNEs to artificially avoid PE status.

However, for this third strategy, Action 7 adopts a different, more assertive, approach to the path that needs to be implemented to correctly address the causes and practices identified, to restore taxing rights to source countries by preventing the artificial avoidance of PE status. In this sense, Action 7 adopts heads-on a substantial modification to the DAPE concept's policy[534].

This shift in policy goes to the heart of the issues identified and the causes of the BEPS practices, with effect, Action 7 takes the stance that where a foreign enterprise is significantly involved in the Source Country through a non-independent agent's activities, then it should be considered that there is a sufficient taxable nexus therein, a PE[535].

This should be understood as, where an agent exercises activities in the Source Country that lead to the regular conclusion of contracts that will be performed by the principal, then that principal has a sufficient taxable nexus therein unless the agent's activities are carried out as part of an independent business[536]. The focus would rest on the execution of the concluded contracts and not so much on the fashion or where these are effectively concluded[537].

The apparent outcome of this revolutionary paradigm shift to the DAPE concept seems to also target the division between countries on the "binding" element of the "in the name of" criterion, which could unify the countries' interpretation of article 5 (5) OECDMC and narrow the MNEs' operational margin of avoidance of PE status, towards a less formalistic approach[538]. However, this policy shift needs to be followed by actual modifications to that provision's wording and Commentary so that it is put into effect.

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534 *Ibid*.
535 *Ibid*; BRAUNER, Yariv – *Treaties in the*… p. 1008.
536 *Ibid*.
537 BRAUNER, Yariv – *Treaties in the*… p. 1008.
538 AUSTRY, Stéphane – *Chapter 12: PE*… p. 487.

Action 7 stresses that modifications to the wording and Commentary are needed, especially to ensure that the above policy modification is properly reflected, and the proposed new wording for article 5 (5) OECDMC seems to follow the path of Action 7's policy for it, resulting in a provision with a substantially broader scope and a lower threshold[539]:

"*5. Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6, where a person ~~other than an agent of an independent status to whom paragraph 6 applies~~ is acting in a Contracting State on behalf of an enterprise and ~~has, and habitually exercises, in a Contracting State, an authority to conclude contracts~~, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are*

a) in the name of the enterprise, or

b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or

c) for the provision of services by that 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 person 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 PE under the provisions of that paragraph"[540]

Action 7's proposed solution modifies article 5 (5) OECDMC by taking into account its fragilities and the BEPS causes and practices explained, as these amendments target those practices and effectively introduce a wider scope to this provision by encapsulating activities that were capable of artificially eluding the DAPE's net[541]. Adding to the wider scope, this proposed solution also bears a lower

[539] OECD – *Preventing the Artificial*… pp. 15-16.
[540] OECD – *Preventing the Artificial*… p. 16.
[541] LIEBMAN, Howard M. – *Chapter 11: Base*… p. 6; MEHTA, Amar – *Chapter 4: The*… p. 4; TRACANA, Dinis –*The Effect of*… p. 215; HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 23; RIBEIRO, Cláudio de Paiva – *A tributação do*… p. 47; EISENBEISS, Justus – *BEPS Action 7…* p. 487; GARBARINO, Carlo – *Permanent Establishments and*… p. 375.

threshold for a PE to exist, by loosening the existing narrow criteria based on a more legal and formal perspective and concentrating on the activities, both of the agent and the principal[542].

Under this proposed wording, MNEs would no longer be able to shield themselves behind commissionaire arrangements, since, as explained, under these arrangements although it is the agent that concludes the contracts, it is the principal that effectively performs and executes the contract, which is this new wording's exact purpose and target, hence the likelihood of the principal reaching the PE's threshold increases[543].

The same applies to the similar strategies identified, with the agent habitually playing the main role leading to the conclusion of contracts that are regularly concluded by the principal, without noteworthy modifications, as the location of where the contract is effectively concluded becomes irrelevant and a DAPE would likely arise[544].

Despite the significant modifications proposed, article 5 (5) OECDMC still maintains its former core, meaning that Action 7 opted to update the existing provision, building upon what was already present, and somewhat operational, instead of creating a whole new provision, yet, the proposed modifications generate a new DAPE concept, which should be less susceptible to artificial avoidance, the flaw of its predecessor[545].

Action 7's proposed amendments keep most of the previous wording, including the exclusion for preparatory or auxiliary activities, and updates it on the reference to article 5 (6) OECDMC and the independent agent status, becoming clearer the

[542] TRACANA, Dinis –*The Effect of*… p. 215; HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 23; PROXENOS, Jolani – *An analysis of*… pp. 34, 36; JIMÉNEZ, Adolfo J. Martín – *The Spanish Position*… p. 468; EISENBEISS, Justus – *BEPS Action 7*… p. 487;
[543] LIEBMAN, Howard M. – *Chapter 11: Base*… p. 6; MEHTA, Amar – *Chapter 4: The*… p. 4; TRACANA, Dinis –*The Effect of*… p. 215; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 505.
[544] OECD – *Preventing the Artificial*… pp. 16-17; LIEBMAN, Howard M. – *Chapter 11: Base*… p. 6; MEHTA, Amar – *Chapter 4: The*… p. 4; CUNNINGHAM, Kevin – *The Post-BEPS World*… pp. 504-505; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 33.
[545] PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 443; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 141-142.

importance of this status to the DAPE concept and strengthening our view on the integration theory between both provisions[546].

The potentially ground-breaking aspects of this proposed solution come from the provision's new elements, like the extension of the method by which the agent may give rise to a PE of its principal, since besides habitually concluding contracts in the Source Country in the name of the latter, the activities executed by the agent therein regarding contracts concluded by the principal may also originate a PE, meaning that the agent no longer needs to conclude the contracts on behalf of the principal for its activity to be deemed to create a DAPE in the Source Country for the principal[547].

This proposed modification would significantly alter the application of article 5 (5) OECDMC given that its essence lies in the agent's activities in the Source Country and these become more relevant with a wider scope, and it also goes directly against the similar strategies aforementioned under which contracts would be substantially negotiated in the Source Country but finalised or concluded in the MNEs' Residence Country, moving away from a formal conclusion approach[548].

In fact, this amendment can be traced back to the Commentary on article 5 (5) 2014 OECDMC and is in line with our extensive interpretation on the conclusion of contracts on behalf of the principal, which could prevent artificial avoidance in this regard, as per our remarks on Chapter 1.

Furthermore, Action 7's proposed solution modifies this provision's structure and introduces two new situations that give rise to a DAPE, adding to the existing one of contracts in the name of the principal. Article 5 (5) OECDMC's suggested paragraphs comprise these three situations, paragraph (a) for the existing one and paragraphs (b) and (c) for the new ones.

Paragraphs (b) and (c) are new provisions that target commissionaire arrangements and similar strategies by focusing on the contract's execution and not

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[546] PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 443; KAROLYI, Balazs – *The Challenges of*… pp. 40-41; GARBARINO, Carlo – *Permanent Establishments and*… pp. 375-376.
[547] HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 23; JIMÉNEZ, Adolfo J. Martín – *The Spanish Position*… p. 468; CUNNINGHAM, Kevin – *The Post-BEPS World*… pp. 504-505; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 33, 141-142.
[548] CUNNINGHAM, Kevin – *The Post-BEPS World*… pp. 504-505; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 33.

on who is legally bound by it, *i.e.* they adopt a position closer to the economical bond commented in Chapter 1 that could bring those arrangements within the DAPE's realm since the principal is the one that effectively executes the contract[549]. Paragraph (b) focus on the sale or usage of property owned or used by the principal and paragraph (c) on the provision of services by the principal, both traditional situations in commissionaire arrangements and similar strategies[550].

These three paragraphs are alternative provisions, meaning that each situation may give rise to a DAPE for the principal, also, the modification to the scope of the agent's activities relevant for this purpose (*i.e.*, concluding contracts or playing the principal role) applies to all three paragraphs in the same manner, which together comprise article 5 (5) OECDMC's proposed renovation, expanding its scope[551]. From these three paragraphs' alternative nature, together with the overall purpose of Action 7 against commissionaire arrangements, it clearly results that there is no need for a legally binding element between client and principal within paragraphs (b) and (c), instead, both rest on the economic link created by the concluded contract between the parties[552].

Action 7's proposed solution places its focus on the substance and economical aspects of the arrangements between agents and principals by including in this provision subjective features connected with the concluded contracts' object and with who executes them, and on the agent's involvement until the effective conclusion of the contracts, which differs from the previous legalistic and formal approach we followed, together with most Civil Law countries, but without discarding the legally binding approach in paragraph (a)[553].

The recommended solution seeks to prevent the artificial avoidance of PE status through the use of commissionaire arrangements and similar strategies, hence the

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[549] OECD – *Preventing the Artificial*… pp. 20-21; HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 24; KAROLYI, Balazs – *The Challenges of*… p. 41; JIMÉNEZ, Adolfo J. Martín – *The Spanish Position*… p. 468; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 505; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 141-142.

[550] OECD – *Preventing the Artificial*… pp. 20-21; KAROLYI, Balazs – *The Challenges of*… p. 41; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 505.

[551] GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 31.

[552] KAROLYI, Balazs – *The Challenges of*… p. 41; JIMÉNEZ, Adolfo J. Martín – *The Spanish Position*… p. 468; EISENBEISS, Justus – *BEPS Action 7*… p. 487.

[553] *Ibid*; OECD – *Preventing the Artificial*… pp. 20-21; HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 23; CUNNINGHAM, Kevin – *The Post-BEPS World*… pp. 504-505; BARBIER, Casper – *The Permanent Establishment*… p. 60; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 33.

focus on the agent's activities throughout the contracts' negotiation and their concrete execution by the principal, piercing through the veil created by those strategies, which were found to be abusively distorting the purpose of the DAPE by avoiding this status despite a significant economic presence in the Source Country[554].

Considering our illustrative example above, even though the contracts are concluded by Company U in its name, Company T would no longer be able to avoid PE status in country U because it would fall within article 5 (5) OECDMC's proposed paragraph (b), as the orthopaedic products are owned by Company T and the concluded contracts are for the transfer of their ownership, from Company T to the clients. The same would occur if the contracts were for services to be rendered by Company T, under paragraph (c).

Therefore, country U would no longer have its taxing rights limited to the 5% commission under the commissionaire arrangement, since it would also have taxing rights over Company T's profits connected with its business presence therein, thus increased source taxation as per Action 7's objectives.

As noted, Action 7's solution is not limited to article 5 (5) 2014 OECDMC's wording, it also recommends amendments to the latter's Commentary in complement to the substantial changes proposed to its wording, clarifying certain aspects and providing further guidance on its new elements together with examples to smooth the proposed solution's application[555].

Action 7's recommended Commentary are detailed and seek to resolve some of the issues identified in Chapter 1 and that still apply, while trying to prevent the rise of others that could potentially surge due to the new measures.

The proposed Commentary identifies the conditions that need to be met for a DAPE to exist, basically the elements of this provision's wording, and the two exclusions that prevent its existence, the independent agent status and the preparatory or auxiliary activities (as per the solutions proposed for article 5 (4)

[554] OECD – *Preventing the Artificial*… pp. 20-21; JIMÉNEZ, Adolfo J. Martín – *The Spanish Position*… p. 468; CUNNINGHAM, Kevin – *The Post-BEPS World*… pp. 504-505; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 32-33.
[555] OECD – *Preventing the Artificial*… pp. 17-23.

OECDMC)[556]. Also, it provides guidance on these conditions and exclusions and adjusts the previous Commentary.

Specifically, by reference to the preparatory or auxiliary activities' exclusion, the proposed Commentary clarifies the reasoning behind it and the interconnection between article 5 (4) and (5) OECDMC, including an example of an agent habitually concluding purchase contracts in the name of the principal, which may not lead to a PE if that activity is preparatory or auxiliary under article 5 (4) OECDMC[557].

As per the wording's proposed revision, Action 7 removes the references to the authority of the agent and its scope vis-à-vis the principal, being more relevant the nature of the activities the agent carries out[558]. However, the agent's activities leading to the conclusion of contracts must not be those of mere promotion or advertising, they need to go beyond these for the principal to be found to be engaged in a business activity in the Source Country.[559]

Action 7's proposed Commentary also clarifies the "on behalf of" criterion, stating that it is verified when the agent significantly involves the principal in business activities in the Source Country, such as in the case of a partner acting for a partnership or an employee acting for an employer therein. In this regard, there is also a relevant clarification to when the agent is a company since the actions of that company's directors and employees should be jointly considered for this assessment, aggregating the activities beneath the company as a sole agent[560].

On the conclusion of contracts by the agent, Action 7's solution upholds that the assessment of whether they are concluded in the Source Country should be executed considering the relevant law governing contracts, which may differ substantially between countries, leading to divergent practices once again, however, it maintains the reference that when the agent negotiates all elements and details of the contract

[556] OECD – *Preventing the Artificial*… p. 18.
[557] *Ibid*.
[558] OECD – *Preventing the Artificial*… p. 17; RIBEIRO, Cláudio de Paiva – *A tributação do*… p. 46; PROXENOS, Jolani – *An analysis of*… pp. 34, 36; PRAKASH, Kruthika – *Permanent Establishment under the OECD Model (2017) Based on the Principal Role Leading to the Conclusion of Contracts – a Doctrinal and Policy Analysis*. Bulletin for International Taxation. Volume 74, number 11 (2020) p. 672.
[559] OECD – *Preventing the Artificial*… pp. 17, 21; PRAKASH, Kruthika – *Permanent Establishment under*… p. 672.
[560] OECD – *Preventing the Artificial*… p. 18.

in the Source country, binding the principal, it is understood as been concluded therein, even if the contract is signed outside of it[561].

Differently, when the agent does not conclude the contracts but takes the principal leading to their regular conclusion without material modification by the principal, the previous path cannot be followed, yet, a PE may still be deemed to exist as Action 7 proposes a different test, based on a direct consequential relation between the agent's activity and the conclusion and execution of the contracts by the principal, which is typically verified when the agent's actions convince the client to conclude the contract with the principal[562].

This added focus on the agent's activities taking the principal role leading to the conclusion of contracts, instead of just the proper conclusion of contracts, is a direct consequence of the BEPS practices identified and Action 7 intends to expand the provision's scope to include what some authors refer to as "rubber-stamp" arrangements, where the place of conclusion of contracts is artificially shifted out of source countries, bringing these arrangements' substance within the scope of this provision and increasing the likelihood of surpassing the DAPE's threshold[563].

For instance, these situations may occur with sales forces that solicit and receive orders and, without finalizing them, send them to the principal for the sale of its products, which are routinely approved by the principal and the products delivered to customers, these orders can be standard terms that are drafted by the principal since the relevance lies in the agent's activities convincing the client to enter into that contract with the principal, *i.e.* the relationship between agent and client[564].

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[561] OECD – *Preventing the Artificial*… pp. 18-19; GARBARINO, Carlo – *Permanent Establishments and*… p. 376; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 143-145.

[562] OECD – *Preventing the Artificial*… p. 19; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 31; EISENBEISS, Justus – *BEPS Action 7…* p. 488; GARBARINO, Carlo – *Permanent Establishments and*… p. 376; CUNNINGHAM, Kevin – *The Post-BEPS World*… pp. 504-505; KAROLYI, Balazs – *The Challenges of*… p. 43.

[563] GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 31; SHTROMBERG, Alexandra – *Managing Permanent Establishment*… pp. 59-60; EISENBEISS, Justus – *BEPS Action 7…* p. 488; GARBARINO, Carlo – *Permanent Establishments and*… p. 376; CUNNINGHAM, Kevin – *The Post-BEPS World*… pp. 504-505; GARBARINO, Carlo – *Permanent Establishments and*… p. 376; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 33; PRAKASH, Kruthika – *Permanent Establishment under*… p. 672.

[564] OECD – *Preventing the Artificial*… pp. 19-20; GARBARINO, Carlo – *Permanent Establishments and*… p. 376; KAROLYI, Balazs – *The Challenges of*… p. 43; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 142, 146.

On the contrary, those situations do not occur where the agent's activities are simply marketing and promotion services that do not directly result in the conclusion of contracts, such as in the case of pharmaceutical sales representatives that market their principal's drugs to medics who may subsequently prescribe them, in this case, there is no contract between the medics and the pharmaceutical company, the patients are the ones that effectively acquire the products[565].

Notwithstanding, considering the subjectivity at play in this regard, it is always necessary to assess each case taking into account all facts and circumstances that surround it to clearly conclude if the agent takes the principal role leading to the routine conclusion of the contracts by the principal without material modification, for instance, a marketing services company may still originate a PE for its principal, contingent on the role it plays[566].

One of the proposed Commentary's clarifications targets directly an aspect commented in Chapter 1, by asserting that paragraph (a) may also apply to situations where the principal's name is undisclosed to the client. Also, Action 7's proposed Commentary maintains the concern of a DAPE assessment based on each business' specifics and that the agent's activities are carried out by reference to the principal's core business activity[567].

The proposed Commentary provides relevant guidance to paragraph (b), clarifying that this paragraph still applies to future property, property that is not yet owned by the principal or that it still does not exist at the time of the contract, and that it encompasses both tangible and intangible property, which is increasingly relevant in the current economy and would be a significant leap forward for article 5 (5) OECDMC[568].

Nevertheless, it is crucial to distinguish these situations from those of distributors buying the products they sell from their parent company, which is unlike a commissionaire arrangement, as the distributor contracts for its own behalf and will acquire and have legal title over the products it sells, even if for a brief

[565] OECD – *Preventing the Artificial*… p. 19; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 148.
[566] EISENBEISS, Justus – *BEPS Action 7…* p. 488; KAROLYI, Balazs – *The Challenges of*… p. 43; PRAKASH, Kruthika – *Permanent Establishment under*… p. 674.
[567] OECD – *Preventing the Artificial*… pp. 21-22.
[568] OECD – *Preventing the Artificial*… p. 21.

period, being taxed not over a commission but the realized profits, hence the carve-out made in Action 7 for LRDs[569].

This distinction is relevant not only for paragraph (b) but also paragraph (c), on the provision of services, in so long as the person in the Source Country is acting in its own behalf and not on that of the foreign enterprise, this could be a typical case of servicer companies managing portfolios of distressed assets held by foreign investment funds.

Action 7's proposed Commentary manages to address an important criticism placed on article 5 (5) 2014 OECDMC Commentary, which is the lack of substantial guidance on the interpretation and application of the DAPE, especially considering its importance in the international taxation system[570].

Overall, Action 7's proposed solution would clearly cause a significant increase in PEs, especially because the commissionaire arrangements and similar strategies it targets would fall under article 5 (5) OECDMC's proposed scope, also, the emphasis placed on subjectivity and the substance of the relevant situations mean that it would be harder for MNEs to avoid DAPE status.

2.3.4.3. Analysis

Having completed the explanation on Action 7's proposed solution to prevent the artificial avoidance of PE status through commissionaire arrangements and similar strategies, it bears to critically analyse it vis-à-vis its objectives, prevention of these practices and eradication of their causes, aiming at restoring fair allocation of taxing rights to where there is a sufficient taxable nexus and presence.

In this sense, we reckon that the path chosen by Action 7 to fight those artificial avoidance strategies is suitable to accomplish its goals. Evidently that the amendments and solutions recommended substantially lower the DAPE's threshold through a wider scope of application from both the agent's activities perspective and the concrete situations involving the principal that may lead to DAPE status,

[569] *Ibid*; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 560; GARBARINO, Carlo – *Permanent Establishments and*… p. 376.
[570] The proposed Commentary also includes a reference regarding profit allocation, which should follow article 7 OECDMC.

establishing a concern with the underlying substance and not exclusively with the form[571].

MNEs would no longer manage to shield themselves behind the commissionaire and similar strategies' form and the absence of legal bond, or the effective location of the conclusion of contracts[572].

Also, the threshold is lowered not only by reference to commissionaire and similar strategies but in a comprehensive manner across the whole article, including paragraph (a), thus increasing DAPE risk for MNEs involved in cross-border endeavours[573].

With this lower threshold, the proposed solution would most likely lead to an increase of PEs in source countries, especially for MNEs that use commissionaire and similar strategies, considering that they are directly and efficiently targeted by Action 7, also, this solution would block avoidance attempts through those strategies since the absence of a legal bond is no longer a factor to consider, nor is the conclusion of the contract by the agent[574].

Consequently, source countries would expect an increase in tax revenue, as they would have taxing rights over the principal's profits, in line with Action 7's goal of restoring taxation to where value is created and where there is a significant economic presence[575].

Action 7 could accomplish its goals through article 5 (5) 2014 OECDMC's suggested modifications, and it would be doing so without rewriting its wording or Commentary. Action 7's solution is not prejudicial to the DAPE's former application, instead, it is built upon the existing provision and equips it with the necessary

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[571] CUNNINGHAM, Kevin – *The Post-BEPS World*… pp. 504-505; EISENBEISS, Justus – *BEPS Action 7…* p. 489; EISENBEISS, Justus – *BEPS Action 7…* p. 492; KAROLYI, Balazs – *The Challenges of*… p. 41; SHTROMBERG, Alexandra – *Managing Permanent Establishment*… pp. 59-60; TRACANA, Dinis –*The Effect of*… p. 215; BARBIER, Casper – *The Permanent Establishment*… p. 60; PRAKASH, Kruthika – *Permanent Establishment under*… p. 679.

[572] GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 35; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 504; EISENBEISS, Justus – *BEPS Action 7…* p. 492.

[573] TRACANA, Dinis –*The Effect of*… p. 215.

[574] *Ibid*; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 35; EISENBEISS, Justus – *BEPS Action 7…* p. 489; KAROLYI, Balazs – *The Challenges of*… p. 41; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 32-33; LANKHORST, Paul; VAN DAM, Harmen – *Post-BEPS Tax Advisory*… p. 67.

[575] CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 504.

elements to render ineffective the prejudicial strategies MNEs have been adopting, while also improving its former application[576].

These amendments and solutions' outcome would be a more effective DAPE concept, and one immune to commissionaire and similar arrangements. This is a noteworthy aspect, considering that the DAPE concept is a key feature in the international taxation system and it has been generally operational and effective, despite some issues and disregarding the strategies addressed herein. It is meritorious that Action 7 opted to preserve the existing operational core structure and simply added the necessary elements to prevent the BEPS practices identified.

Also, Action 7's solution manages to bring much-needed clarity to the discussion commented on the division between Civil Law and Common Law countries over the interpretation and application of this provision since it proposes a dual focus on it, one holding on to the legal bond and another adopting an economic/substance bond between principal and client, therefore, regardless of the country's legal family and the existence of a legal bond, the relevant country could apply this proposed solution[577]. As noted, this aspect is vital for Civil Law countries.

The apparent conclusion of the discussion around article 5 (5) OECDMC's interpretation is commendable, with the approach taken deserving particular praise since Action 7 did not take a side on it nor proposed a third, compromise, path, instead, it added elements typical of Common Law systems to the provision in a way to please all parties and prevent loopholes, a rare statement of a common and unified approach therein. In this sense, MNEs would no longer be able to reap unlawful benefits from divergent country practices, as the provision bears the formal and the substantive approach.

On top of the adequate modifications to the policy and the wording of this provision, Action 7's solution also showcases a concern over its correct interpretation and application by including detailed and extensive Commentary on it, which is a general flaw of Action 7. Albeit there are questions with the suggested

[576] PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 443.
[577] HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 24; EISENBEISS, Justus – *BEPS Action 7…* p. 492.

Commentary, the intention to address potential doubts arising from the proposed modifications is unmistakably present.

This becomes clear with the interconnection between article 5 (4), (5) and (6) OECDMC, especially on the preparatory or auxiliary activities, as it ties both solutions together, which were less clear in article 5 (5) 2014 OECDMC's Commentary. On the relationship between article 5 (5) and (6) OECDMC, we maintain that the integration theory still is the one most suited to interpret the relation between both articles, even more so since there is a direct reference that the latter's provisions apply[578].

Although we find Action 7's recommended course of action suitable to stop commissionaire and similar arrangements from eluding PE status, several facets deserve criticism and are a cause for grave concern about its application as is, mostly regarding spillover effects, which should be properly addressed prior to effective implementation of this proposed amendments and solutions.

It is evident that a wider scope in article 5 (5) OECDMC was needed to effectively stop commissionaire and similar arrangements from eluding PE status, however, as pointed out, Action 7's recommendation in this regard is too broad and it may cause other legal arrangements, that do not have an avoidance intent, to fall under the scope of that provision and possibly originate a PE, which overdoes Action 7's objective and purpose[579].

This issue lies at the foundation of Action 7, where, contrary to our view, it claims that commissionaire arrangements and similar strategies are generally artificial and abusive legal instruments, without considering genuine and sound reasons for the implementation of these instruments, such as business strategy or cost-efficiency[580]. From this base, the recommended solution inaccurately assumes

[578] PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 443; KAROLYI, Balazs – *The Challenges of*… pp. 40-41.
[579] HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 30-33, 35-36; TRACANA, Dinis –*The Effect of*… p. 215.
[580] GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 35-36; HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 33-36; EISENBEISS, Justus – *BEPS Action 7…* p. 492; PLEIJSIER, Arthur – *The Agency Permanent Establishment In BEPS Action 7: Treaty Abuse or Business Abuse?*. Intertax. Volume 43, issue 2 (2015) p. 153; LANKHORST, Paul; VAN DAM, Harmen – *Post-BEPS Tax Advisory*… p. 67.

that those instruments are inherently abusive and artificial, thus the solutions proposed are also general and blind to concrete situations[581].

It would be different if Action 7 targeted the commissionaire and similar arrangements that were implemented in substitution of previous distributor arrangements, with a tax-driven avoidance reasoning distorting the spirit of article 5 (5) OECDMC, yet, that is not the outcome presented by Action 7[582].

The proposed solution engulfs activities that were once artificially avoiding PE status and others that perhaps were rightfully beneath the threshold, again, there was little concern over this solution's spillover effects and their potential impact on cross-border ventures[583].

In this sense, any commissionaire and similar arrangement would almost inevitably lead to a PE, contingent on the independent agent status, even if they have genuine and valid economic reasons and taxation was not a factor.

As such, this recommended solution should be refrained by expressly referring to the facts and circumstances surrounding each case and targeting only the structures that are effectively abusive and artificially avoiding PE status[584]. Also, a potential solution for this issue could be the implementation of a specific anti-avoidance rule within article 5 (5) OECDMC's wording, to only target the arrangements that are effectively artificially avoiding PE status and allow the ones with sound business reasons to remain outside the scope of this provision[585].

In this regard, we find Action 7's solution to be disproportionate vis-à-vis its objective of preventing artificial avoidance, as it surpasses it without proper justification[586].

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581 GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 35-36; HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 31-33, 35-36.
582 HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 30-33, 35; EISENBEISS, Justus – *BEPS Action 7…* p. 492; CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 12-13.
583 GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 35-38; HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 30-33, 35-36; EISENBEISS, Justus – *BEPS Action 7…* p. 492; PLEIJSIER, Arthur – *The Agency Permanent*… p. 153.
584 GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 35-36; CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 12-13.
585 EISENBEISS, Justus – *BEPS Action 7…* p. 492; PLEIJSIER, Arthur – *The Agency Permanent*… p. 153; CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 12-13.
586 HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 32-34; EISENBEISS, Justus – *BEPS Action 7…* p. 492; CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 12-13.

Additionally, with such a broad scope, this suggested provision may also prove to be detrimental to accomplished and successful agents and praise the average ones in relation to their role leading to the conclusion of the contracts, since if they are effective and manage to execute their role with minimum intervention from the principal, other than the approval of the contracts, they may originate a PE because they may be found to be playing the principal role in the conclusion of routinely approved contracts[587].

Conversely, the average, or worse, agents that require more intervention from the principal would not have such a concern because the principal needs to be greatly involved in those contracts' negotiation and conclusion.

Also, as under the proposed Commentary this provision would also include situations where agents just convince and send standard terms and conditions without any negotiation, most sales/negotiation teams could fall under Action 7's proposed solution, which goes beyond its initial purpose and could make it overbearing on business activities, leading to disputes[588].

Considering that the focus would be placed on the agent convincing the client to contract with the principal, this provision may be extrapolated to other situations that have not been considered so far, such as lobbyists and similar functions.

Further to the above comments on the recommended Commentary, even though they are detailed and extensive, especially when concerning the rest of Action 7, they are still flawed and insufficient for a smooth interpretation and application of the intended solution. In this sense, it is astonishing how Action 7 proposes the introduction of new concepts and deprives them of any guidance, even more so on key concepts of the proposed wording such as "material modifications" or "principal role".

With effect, the Commentary is silent on how should "material modification" be interpreted in the context of the proposed shift in policy and wording, it is an open-ended concept that would most likely create divergent interpretations and

[587] PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 443.
[588] CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 506; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 35; KAROLYI, Balazs – *The Challenges of*… p. 43.

applications, distorting Action 7's purposes and potentially leaving operational room for MNEs to avoid PE status[589].

Material modifications should refer to the key elements of the contract, but does it occur only when all the key elements are modified or would it also occur when only one, such as the price or the location of execution, is modified? What level of involvement is required from the principal, just more than mere "rubber-stamping"? Would the key elements also be subject to the relevant country's contract law? Questions left answered by the Commentary on a new concept.

Also, even if at a different level, the Commentary is scarce on guidance over the interpretation of "principal role", the examples provided are insufficient and allow different interpretations from tax administrations and MNEs, causing uncertainty and potential disputes, for instance, how should one assess the principal role, would it be by comparison to the principal's role in that contract, or to the overall contracts concluded, or by comparison with other agents, what activities should be seen as constituting the principal role[590]? Again, relevant questions left answered.

Together with the open concepts, and as a result of the adoption of an approach focused on the underlying substance, there is ample room for subjective interpretations within Action 7's solution, which it seems to welcome as a protection technique towards abusive practices[591].

However, despite the advantages stemming from a flexible subjective interpretation against abusive practices, such technique may bring more harm than good, since subjectivity often causes divergent interpretations between countries, tax administrations and taxpayers, hence paving the way to legal uncertainty, loopholes and disputes, which are a MNE's playground for avoidance[592].

There is a heavy subjective connotation within Action 7's amendments and solutions that could be prejudicial to the objectives it seeks to accomplish and could

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[589] EISENBEISS, Justus – *BEPS Action 7…* p. 489; PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 443; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 311; BARBIER, Casper – *The Permanent Establishment*… p. 61; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 150.
[590] SHTROMBERG, Alexandra – *Managing Permanent Establishment*… p. 60; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 311; KAROLYI, Balazs – *The Challenges of*… p. 43; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 147; PRAKASH, Kruthika – *Permanent Establishment under*… p. 670, 677-678.
[591] HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 23.
[592] *Ibid*.

lead article 5 (5) OECDMC back to the divergent interpretations that caused the practices it seeks to prevent, as such, the subjective elements should be restricted, for instance through detailed and objective guidance in the Commentary to provide further certainty, which is a vital aspect in business[593].

Open concepts, lack of guidance, subjectivity and economic approaches cause legal uncertainty in relation to an important provision such as article 5 (5) OECDMC, which is detrimental to cross-border business, reason why should this solution be implemented without significant improvement, disputes between taxpayers and tax administrations could soar[594].

Furthermore, despite Action 7's concern with commissionaire and similar arrangements, the carve-out made regarding LRDs could wound the solution, since it is fairly easy for MNEs to simply shift their business models from commissionaires to LRDs, considering it will only require a new contractual arrangement between the same parties and that the LRD can operate based on a "flash title" over the products it sells[595][596].

Should MNEs embrace LRDs, from a substance standpoint, the existing differences to commissionaire arrangements are slim, and even though the Source Country would be able to tax the distributor's profits, rather than a commission, it is questionable whether those profits would be substantial in comparison to the commission, even if at arm's length[597].

We cannot but regard "flash title" LRD arrangements as akin to aggressive tax planning schemes, once again shielding beneath an almost artificial title over the products to escape article 5 (5) OECDMC[598]. We find that Action 7's solution could also be a suitable option to prevent LRD arrangements, on top of the work conducted in Action 6 and 9, however, substantial modifications would be needed.

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[593] HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 23-24.
[594] CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 506; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 36-38; BARBIER, Casper – *The Permanent Establishment*… p. 61.
[595] A "flash title" occurs when the distributor only takes possession of the products it sells for a very brief moment, usually immediately before concluding the sale/delivering the product.
[596] DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 560; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 154-155.
[597] PLEIJSIER, Arthur – *The Agency Permanent*… pp. 152-153; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 560.
[598] SHTROMBERG, Alexandra – *Managing Permanent Establishment*… p. 57; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 560.

From another perspective, the shift from commissionaire arrangements to distributor arrangements, even if low-risk (but not based on "flash title"), still is an acceptable consequence intended by Action 7, as through that modification the Source Country will have taxing rights over the business profits that used to be smuggled out. In either scenario, the existence of a PE in the Source Country or the shift to distributor arrangements, Action 7's main goal would be verified, as there would be a sufficient taxable nexus in the Source Country.

However, eventual modifications to business models may not have a favourable outcome, as MNEs may continue to avoid PE status through simple measures, such as emphasising their role in the conclusion of contracts or reducing the local agents to mere promotional or supporting activities[599]. It would be again a matter of interpretation of a subjective and open-ended concept, which lacks proper guidance.

As stated, to present an effective strategy to prevent the BEPS causes and practices identified it was necessary to amend and modify article 5 (5) 2014 OECDMC, which had to entail a wider scope and lower threshold to include situations that were able to elude its reach despite a significant presence in source countries. With effect, Action 7's solution succeeded in this provision's revision and in putting forward a solution that embodies a lower threshold and wider scope capable of preventing the artificial strategies identified from continuing to avoid PE status.

From that point of view, we find that Action 7's solution could be apt to achieve its objective, considering that under the revised provision those BEPS strategies would fall under its scope and it would be next to impossible to avoid PE status.

Nevertheless, Action 7's solution is designed in a way that it is not satisfied by just catching artificial arrangements, in fact, the proposed solution goes well beyond that, resulting in a disproportionate overkill provision that damages the potential benefits that could arise from it. Under Action 7's proposed DAPE concept, almost any business presence in another country by a foreign enterprise could give rise to a PE.

[599] KAROLYI, Balazs – *The Challenges of*… pp. 43-44; PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 443; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 155-156.

In our view, Action 7 would be creating a new DAPE concept with a threshold too low for it to continue to be a relevant element within the international taxation system without being prejudicial to cross-border activities by foreign enterprises.

We find that Action 7's solution has failed in relation to the objectives sought, of preventing artificial avoidance practices, by improperly overstepping them beyond a proportionate limit. This solution should be revised before implementation.

Despite this solution's virtues, should it be implemented without significant revision of the exposed issues, we expect that the positive effects will be supplanted by the negative ones, legal uncertainty would become a factor and tax administrations seeking PEs would be given substantial ammunition to pursue any foreign enterprise with a business presence in their country, leaving enterprises to resort to disputes even though they would have a limited ability to prevent that qualification.

The alternatives we offer to refrain and limit to its intended targets could rescue its merits since we find the path taken to be generally adequate to prevent the artificial avoidance strategies in place, unfortunately, without them this proposed solution would be going too far.

Despite our segregation of the third BEPS strategy into two features, due to their causes and practices and solutions, they are tightly connected, hence the solutions recommended by Action 7 for both features reach their apex when seen together as complementary provisions.

Following the above, we conclude our analysis on Action 7's recommended solution to prevent the practices identified in relation to the first feature of the third BEPS strategy, where the causes and practices leading to the artificial avoidance of PE status based on article 5 (5) 2014 OECDMC were presented and Action 7's answer to stop and prevent such artificial avoidance was explained, based on its virtues and downfalls.

2.3.5. Article 5 (6) 2014 OECDMC – independent agent status and related enterprises

In this final subsection and we will address the second feature of the third BEPS strategy, which relates to article 5 (6) 2014 OECDMC and the independent agent status.

The third BEPS strategy's second feature's cause and practices derive from strategies similar to commissionaire arrangements, similar in the sense that they distort and subvert the spirit of the relevant provision, in this case of article 5 (6) 2014 OECDMC.

2.3.5.1. Causes and practices

The first feature of the third BEPS strategy had some influence from article 5 (6) 2014 OECDMC, namely from the automatic qualification of a general commission agent or broker as an agent of independent status, so long as it acted in the ordinary course of its business.

In its turn, the third BEPS strategy's second feature has MNEs directly exploiting the loopholes and shortcomings of article 5 (6) 2014 OECDMC to their advantage so that they may carry on significant business activities in source countries without triggering DAPE status by claiming that the agent has an independent status, thus fulfilling their ultimate goal of avoiding DAPE status and lower tax burden[600].

As established in Chapter 1, article 5 (6) 2014 OECDMC's independent agent status is reached when the agent is both legally and economically independent from the principal, and when its actions are in the ordinary course of its activity. Also, the fact that the agent is a subsidiary of the principal, or is in a group relation, does not jeopardize its independent agent status since the agent will be assessed as a separate entity per article 5 (7) 2014 OECDMC.

Furthermore, the number of principals an agent has provides an indication for the assessment of its independence towards the principal, for example, it is more likely to not be independent if the agent only acts for one principal. However, this is

[600] OECD – *Preventing the Artificial*… p. 15.

merely indicative and it may be disregarded when considering the remainder of the independence test's elements, since these are subjective elements that emanate from the Commentary, leaving the countries to interpret and apply them in the manner they see most suitable.

Moreover, we established that, pursuant to the integration theory on the relationship between article 5 (5) and (6) 2014 OECDMC, when the agent qualifies as having an independent status its activities would no longer be subject to scrutiny under article 5 (5) 2014 OECDMC's criteria, thus no DAPE could exist.

Within this context, the focal point to successfully avoid the PE status clearly lies in securing the agent's qualification as having an independent status, without disregarding the simpler fulfilment of the agent carrying on its own business test, and not that of its principal[601]. Also, these tests are construed based on indicative subjective elements that require a cumulative assessment to consider whether each test is indeed verified or not, thus they are prone to abusive interpretations and practices[602].

In this regard, it matters to recall that MNEs can fairly easy set up subsidiaries throughout countries where they have business activities, and in fact, MNEs' business models often rely on subsidiaries or other group companies for the execution of their local business activities. This, together with the possibility of subsidiaries or group entities being regarded as having an independent status, gave MNEs a loophole that they could exploit and subvert to their benefit[603].

With the loophole identified, MNEs designed and implemented arrangements that allowed them to avoid PE status in source countries by securing the agent's entitlement to the independent agent status, even though both enterprises have a strong relationship, as group entities or parent-subsidiary[604]. In this sense, it is questionable to uphold that related enterprises can qualify as independent agents in the way intended under article 5 (6) 2014 OECDMC, especially when conducting their activities mostly for such enterprises[605].

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601 *Ibid*.
602 KAROLYI, Balazs – *The Challenges of*… p. 33.
603 OECD – *Preventing the Artificial*… p. 15.
604 *Ibid*.
605 PLEIJSIER, Arthur – *The Agency Permanent*… pp. 153-154; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 33-34.

MNEs found that they could maintain related enterprises carrying out agency activities on their behalf as traditional agents and still managed to avoid PE status in source countries because the agent could claim refuge under article 5 (6) 2014 OECDMC, for instance with the agent having other, smaller, principals to dissipate economic dependence, which could be other related enterprises; or even deploying commissionaire or brokerage arrangements for those related enterprises, as these would automatically qualify as having an independent status, as stated in the preceding subsection[606].

With effect, MNEs implemented independent agent arrangements using related entities and even modified existing business structures to accommodate these arrangements, without substantially modifying their presence in source countries, hence avoiding PE status[607].

This becomes clearer through a sample scenario, adding to the one presented regarding commissionaire arrangements, consider Company 1, resident in country 1, that buys and sells select watches to worldwide clients, for that purpose it deploys a string of agents into a multitude of countries, such as Company 2, a wholly-owned subsidiary of Company 1 and resident in country 2. Company 2 carries on its activities as an agent on behalf of Company 1, assuming the risks of its own activity and being remunerated in accordance with the execution of its activities. Also involved in country 2 are Companies 3 and 4, resident in country 3 and each a sister company of Company 1.

Companies 3 and 4 also engage Company 2 as an agent, Company 3 devoted to the jewellery sector and Company 4 integrated into the luxury apparel sector. Company 2 carries on its activities as an agent on behalf of Companies 3 and 4 in the same manner as for Company 1, even though they only account for 8% of its overall business income. As such, Company 2 could be entitled to independent agent status in country 2 and no PE would arise for either company, despite them being related to each other and Company 2 being exclusively engaged by them.

In this case, Company 2 would be entitled to article 5 (6) 2014 OECDMC's benefits as it denotes independence and carries on its own business as an agent, and

[606] KAROLYI, Balazs – *The Challenges of*… p. 33.
[607] *Ibid*; OECD – *Preventing the Artificial*… p. 15.

even though it acts exclusively for related companies and mostly for its parent company, the overall assessment could allow the independent agent status, meaning that the Source Country would only have taxing rights over Company 2's remuneration and not over the business profits of the other companies[608].

Further to our previous comments, and as these arrangements are identified as similar to commissionaire arrangements, Action 7 also regards them as being generally primarily dedicated to BEPS practices leading to the avoidance of PE status through artificial means, which gives rise to the concerns already addressed, hence our advice for refrainment applies[609].

We have exposed the cause and practices implemented by MNEs connected with the third BEPS strategy's second feature, which explore article 5 (6) 2014 OECDMC's loopholes that allow the distortion of the independent agent status' purpose based on subjective indicators as key elements in that article's tests, namely in the legal and economic independence test[610].

MNEs successfully managed to avoid DAPE status, and taxation, in source countries by deploying related companies as agents through artificial structures, while maintaining their business presence therein, resulting again in harmful distortions in the international taxation system and the fair allocation of taxing rights.

In this sense, article 5 (6) 2014 OECDMC clearly needed modifications to prevent MNEs from reaping further gains through the third BEPS strategy's second feature, by eliminating its cause and effectively halting the prejudicial practices implemented.

Further to this point, we advance to the amendments and solutions recommended by Action 7 to reach that objective and restore taxing rights to where they are due and re-equilibrating the scales of the international taxation system, preferably without harming cross-border trade.

2.3.5.2. Amendments and solutions

608 *Ibid*.
609 OECD – *Preventing the Artificial*… p. 15.
610 *Ibid*.

Having identified the cause and practices emanating from the third BEPS strategy's second feature, it matters to address Action 7's recommended amendments and solutions to article 5 (6) 2014 OECDMC to fight them and stop MNEs from continuing to subvert the independent agent status and avoid DAPE status in source countries through related enterprises and almost exclusive relationships with agents.

As stated, the cause for these practices lies in the indicative and subjective elements included in article 5 (6) 2014 OECDMC's independence test, therefore, a decisive modification to this provision's wording and Commentary is needed to prevent these practices, which is also in line with Action 7's direction[611].

Furthermore, as noted, Action 7 proposes a paradigm shift in relation to the policy behind the DAPE concept, clearly including article 5 (5) and (6) OECDMC[612].

This alteration of policy seeks to provide taxing rights to source countries whenever a foreign principal has a sufficient taxable nexus therein, meaning, whenever it has a meaningful business presence in a country derived from the carrying out of contracts it regularly concluded that result from the activities of a local agent unless the latter operates in the course of an independent business[613].

As highlighted, although the target is the foreign principal, the spotlight is set on the agent's activities and if, as a result of those activities, contracts are regularly concluded and will be executed by the foreign principal in the Source Country. Albeit the spotlight is placed over the agent's activities in the new policy, Action 7 provides a safe harbour for agents that perform those activities in the course of an independent business, to limit a potential overarching measure[614].

At this point, we recover our remarks on the intended policy shift since it lays the foundation for Action 7's recommended solutions to prevent the third strategy's BEPS practices as a whole, as these should be interpreted and implemented considering the DAPE concept's new purpose and objective, thus key for the solutions against this second feature's BEPS' practices.

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611 *Ibid*.
612 *Ibid*.
613 *Ibid*.
614 *Ibid*.

However, unaccompanied, the policy modification to the DAPE is insufficient, as article 5 (6) 2014 OECDMC's wording and Commentary do not reflect it, as such, a modification to this provision's wording and Commentary is truly required to prevent the abusive BEPS practices and bring the new proposed policy into force.

In this sense, Action 7's solution appears to address these issues and embrace the new policy through the amendments proposed to article 5 (6) 2014 OECDMC's wording and Commentary:

"*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.~~*

a) *Paragraph 5 shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.*

b) *For the purposes of this Article, a person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise*"[615]

The amendments and modifications to article 5 (6) 2014 OECDMC suggested by Action 7 are substantial, with this provision's wording being scrapped and the

[615] OECD – *Preventing the Artificial*… pp. 16-17.

proposed provisions boasting a simpler and narrower scope of application of the independent agent status, hence increasing the DAPE risk for MNEs involved in the BEPS practices commented[616].

This proposed solution differs from the path followed throughout Action 7's other solutions, as in those it kept the core aspects of the existing provisions that were still valid and built upon it to improve them to prevent the relevant BEPS practices.

Instead, herein, Action 7 sets aside article 5 (6) 2014 OECDMC's wording and recommends a completely new one, which is not meaningless, as it conveys Action 7's intention to implement a significant change to the policy and application of the independent agent status and, consequently, of the DAPE concept. Nonetheless, Action 7's solution still salvaged the ordinary course of the agent's business limitation in the wording, and most of the Commentary[617].

Action 7's solution simplifies article 5 (6) OECDMC's interpretation and application with the removal of the troublesome references to general commission agent and broker, particularly considering the divergent practices between Civil and Common Law countries, hence this amendment also brings clarity and certainty to that discussion and this provision[618].

Under Action 7's solution, there is no longer an automatic qualification as an independent agent, all agents need to surpass the unaltered independence test, which goes directly to the commented BEPS practices' core, and it removes a key cause of those BEPS practices and a safe harbour for MNEs[619].

With all agency arrangements subject to all article 5 (6) OECDMC's tests, the scope of Action 7's recommended exclusion from PE status is narrower than the previous one, hence it would be more difficult for an agent to qualify as an

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[616] KAROLYI, Balazs – *The Challenges of*… p. 41; PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 444; EISENBEISS, Justus – *BEPS Action 7*… p. 489; PROXENOS, Jolani – *An analysis of*… p. 38; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 32, 38; MONSENEGO, Jérôme – *The Independent Agent*… p. 956; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 174.

[617] KAROLYI, Balazs – *The Challenges of*… p. 41; MONSENEGO, Jérôme – *The Independent Agent*… p. 951.

[618] OECD – *Preventing the Artificial*… p. 23; PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 444; GARBARINO, Carlo – *Permanent Establishments and*… p. 378; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 38; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 174-175.

[619] OECD – *Preventing the Artificial*… p. 23; KAROLYI, Balazs – *The Challenges of*… p. 42.

independent agent[620]. Therefore, the DAPE concept's threshold would become lower, leaving MNEs with increased chances of having a DAPE, as more agent arrangements could be subject to analysis under article 5 (5) OECDMC[621].

Together with the direct exclusion of the automatic qualifications, often prone to abuse, Action 7's solution constricts, even more, the scope of application of the exclusion of DAPE status with the introduction of a presumption of dependence for persons that exercise their activities exclusively, or almost, on behalf of one or more closely related enterprises in relation to these enterprises (the dependence presumption), particularly relevant for MNEs' BEPS strategies involving group enterprises[622].

In these situations, the agent shall not be deemed to be an independent agent under article 5 (6) OECDMC and should go through article 5 (5) OECDMC's examination to determine if it constitutes a DAPE for those enterprises or not[623]. Also, the exclusion of entitlement to the independent agent status for the relevant agent is extended to all the closely related enterprises to which it acts in exclusivity, or almost, but not to situations where both criteria are not verified, exclusivity and closely related[624].

This presumption further limits the likelihood of the agent reaching the independent agent status, which lowers even further the DAPE's threshold, making it a pinpoint measure on MNEs' BEPS practices, which would successfully prevent them and restore the independent agent status to its proper purpose, in line with the policy shift of application to separate and independent agents[625].

Action 7 limits the dependence presumption to the qualification as an independent agent and only when the person acts exclusively, or almost, on behalf of closely related enterprises, maintaining for other situations the unaltered independence and ordinary course test, and the caveat that the control of the parent

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620 KAROLYI, Balazs – *The Challenges of*… p. 41.
621 EISENBEISS, Justus – *BEPS Action 7…* p. 489; MONSENEGO, Jérôme – *The Independent Agent*… p. 956.
622 KAROLYI, Balazs – *The Challenges of*… p. 41; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 506; MONSENEGO, Jérôme – *The Independent Agent*… pp. 951, 955.
623 DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 560; MONSENEGO, Jérôme – *The Independent Agent*… p. 951; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 34.
624 OECD – *Preventing the Artificial*… p. 24.
625 OECD – *Preventing the Artificial*… p. 23; EISENBEISS, Justus – *BEPS Action 7…* p. 489; MONSENEGO, Jérôme – *The Independent Agent*… p. 955; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 34.

over the subsidiary is irrelevant in the assessment of dependence, hence avoiding conflicts with article 5 (7) OECDMC and the independent entity approach, which remains applicable and relevant[626].

This solution branches out into two provisions, the first, paragraph (a) which was explained above, focus on the qualification of a person as an independent agent and introduces new concepts to article 5 (6) OECDMC, one of which is "closely related enterprises"; the second one, paragraph (b), has a supportive role to paragraph (a) and to some of Action 7's other already analysed solutions since it defines the closely related concept.

Following Action 7's proposed definition, the closely related concept is based on the notion of control, under which enterprises are considered closely related if one has control over the other or both are under the control of the same person, considering all facts and circumstances, which provides some interpretational range over the notion of control in this regard, which could include arrangements that convey the controlling rights over a company[627].

Action 7 also proposes an objective presumption to limit the subjectivity included in this concept's definition, under which enterprises shall be deemed to be closely related where one has directly or indirectly 50%, or more, of the beneficial interest (or for a company, of the votes and share value or of the equity in it) of the other, or another person directly, or indirectly, has it in relation to both the person and the enterprise (the closely related presumption)[628].

Paragraph (b) could prove to be vital in the implementation of Action 7's proposed solution, since it effectively establishes a considerable obstacle for MNEs to implement BEPS strategies, as it would render infective the arrangements implemented between most group entities, which is common practice in MNEs business models and structures in cross-border ventures, hence it would be

[626] OECD – *Preventing the Artificial*… pp. 24, 26-27; KAROLYI, Balazs – *The Challenges of*… pp. 41-42; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 34.
[627] OECD – *Preventing the Artificial*… p. 26; KAROLYI, Balazs – *The Challenges of*… p. 41; EISENBEISS, Justus – *BEPS Action 7…* p. 489; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 32-33; GILLESPIE, John – *The Base Erosion*… p. 48.
[628] OECD – *Preventing the Artificial*… p. 26; KAROLYI, Balazs – *The Challenges of*… pp. 41-42; EISENBEISS, Justus – *BEPS Action 7…* p. 449; JIMÉNEZ, Adolfo J. Martín – *The Spanish Position*… p. 46.

expectable to witness an increase in DAPEs and the revision of current business models[629].

Action 7's proposed solution to this third BEPS strategy's second feature would be creating significant limitations to MNEs engaged in BEPS practices to avoid PE status and source taxation, since the DAPE's threshold would become lower due to the narrower scope of article 5 (6) OECDMC, which excludes the principal from having such status in source countries, therefore a broader DAPE concept[630].

As established, Action 7's proposed amendments and solutions to article 5 (6) OECDMC extend to the Commentary, where there is a stronger focus on the agents' activities and detailed guidance on the recommended provisions, amending the previous Commentary to better reflect the wording and the policy shift, specifically on the notion of separate and independent enterprises, independent agents, and adding guidance on paragraph (b)[631].

In this regard, Action 7's solution would clearly exclude from the independent agent status's scope persons acting on behalf of an enterprise in a different capacity than that of an agent, for instance, a partner could not be eligible for this status when it acts on behalf of the partnership, or a director for a company[632]. Even if those persons acted in the course of their own business as agents, this status could still be unattainable due to both presumptions[633].

Action 7's proposed Commentary clarifies that the dependence presumption is restricted and would not apply to situations where an agent acts on behalf of a closely related enterprise without exclusivity (or almost), in such cases, the agent could still be entitled to the independent agent status, contingent on the fulfilment of the tests explained in Chapter 1[634]. It also clarifies that if this presumption does not apply, the consequence is not an automatic qualification as independent agent, meaning that the relevant person would still undergo article 5 (6) OECDMC's tests[635].

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[629] KAROLYI, Balazs – *The Challenges of*… p. 42.
[630] TRACANA, Dinis –*The Effect of*… p. 215.
[631] OECD – *Preventing the Artificial*… pp. 23-27; GARBARINO, Carlo – *Permanent Establishments and*… pp. 378-379.
[632] OECD – *Preventing the Artificial*… p. 23.
[633] *Ibid*; EISENBEISS, Justus – *BEPS Action 7…* p. 489.
[634] OECD – *Preventing the Artificial*… p. 24.
[635] OECD – *Preventing the Artificial*… p. 25.

Despite the focus of Action 7's proposed amendments and solutions on the independence test, the Commentary regarding the ordinary course test is also amended to better reflect the policy shift intended. In this sense, under Action 7's solution, the ordinary course of activity test strengthens the focus on the relevant person's activities as an agent, and not on its overall business activities, meaning that only the activities that a person carries out as an agent are relevant in the assessment of its independence, abiding by an external comparison between agents in a similar sector to assert its ordinary course[636].

Action 7's proposed solution includes specific protection for start-ups and early stages companies, where they may act in exclusivity for one enterprise for a brief period without jeopardizing their independence status, which reveals care over the current types of businesses, particularly considering current technological advancements[637]. However, this protection is not extendable to the dependence presumption since it only applies where the enterprises are not closely related[638].

Action 7's proposed solution introduces new concepts to article 5 (6) OECDMC, which, without proper definition and guidance, could lead to uncertainty and disputes, as such, it is highly advisable to also introduce guidance on the interpretation and application of those concepts. One of those concepts is the "exclusively or almost exclusively" concept, concerning the activities executed by the agent for closely related enterprises, which is far from an objective and clear-cut provision, reason why Action 7 includes guidance in the Commentary for this concept's interpretation.

The proposed Commentary indicates that where the agent's sales on behalf of closely related enterprises account for more than 90% of its overall sales activities as an agent then it will be considered as being acting exclusively or almost exclusively on behalf of closely related enterprises since the remainder does not represent a significant part of its business[639].

In this way, Action 7 introduces a 10% test that establishes the threshold for the dependence presumption's application, from where it may be inferred that if an

[636] *Ibid*; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 183-184.
[637] OECD – *Preventing the Artificial*… pp. 25-26.
[638] *Ibid*.
[639] OECD – *Preventing the Artificial*… p. 26; KAROLYI, Balazs – *The Challenges of*… p. 42; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 506; EISENBEISS, Justus – *BEPS Action 7*… p. 489.

agent's sales on behalf of non-related principals' account for 15% of its overall sales then this presumption would no longer apply vis-à-vis the closely related enterprises on which behalf it acts, as those sales would be a significant part of its business as an agent[640].

As exposed, Action 7 foresees the introduction of the closely related concept, a novelty, despite the OECDMC already having a similar concept[641]. Considering the potential doubts arising from similar concepts, it is clarified that even though both concepts may overlap, they are not to be confused with each other, however, a few concerns still arise in this regard[642].

Following the above, and recovering our above example with the luxury accessories companies, under Action 7's proposed solution it is evident that Company 2's independent agent status would be precluded in relation to its activities as an agent on behalf of Companies 1, 3 and 4 because the presumption of paragraphs (a) and (b) would apply, as Company 2 is acting exclusively on behalf of those enterprises and they qualify as closely related enterprises to Company 2.

Therefore, Companies 1, 3 and 4 could be deemed to have a DAPE in country 2, as they would have to undergo article 5 (5) OECDMC's assessment.

2.3.5.3. Analysis

As it results from the explanation above, Action 7's proposed solution for article 5 (6) OECDMC properly reflects the intended policy change for the DAPE concept and we find it to be an appropriate option to prevent the BEPS' causes and practices addressed. Effectively, should this solution be implemented, the arrangements where agents act in near exclusivity on behalf of group companies would be left inoperable vis-à-vis the independent agent status and MNEs would no longer be able to avoid DAPE status through this safe harbour[643].

In this sense, the original spirit and purpose of the independent agent status present in article 5 (6) OECDMC, *i.e.* its application to true unrelated independent

[640] OECD – *Preventing the Artificial*… p. 26; EISENBEISS, Justus – *BEPS Action 7…* p. 489.
[641] The concept of "associated enterprises" in article 9 OECDMC.
[642] OECD – *Preventing the Artificial*… p. 26.
[643] KAROLYI, Balazs – *The Challenges of*… p. 42; MONSENEGO, Jérôme – *The Independent Agent*… p. 956.

agents (*bonafide* agents), would be restored by Action 7[644]. As noted, the OECD finds agent arrangements in almost exclusivity for related enterprises to be BEPS strategies implemented primarily for tax abuse purposes, and, from that perspective, it is clear that this provision would be an effective solution to terminate existing arrangements and prevent futures ones.

Action 7's adoption of two sharp presumptions against these causes and practices would function also as a warning for future strategies, since MNEs would be left with no margin to counter-argue the presumptions or prove their agent's independence, considering their blind and automatic application[645]. This may likely empower tax administrations to seek out and disregard former independent agent statuses, which is the intended goal, however, as commented, tax administrations' action should be proportionate and properly measured.

Furthermore, it is our view that Action 7's method to amend article 5 (6) OECDMC's wording should be pondered while interpreting this provision, should it be implemented, as a deterrent to previous notions and interpretations of the independent agent status.

Action 7's method choice also influences the way the Commentary should be interpreted, especially considering that it opted not to disregard the previous Commentary, instead it amended it in line with the wording and added the required guidance on the newly proposed provisions[646].

When assessing the overall solution, we find that Action 7 took surgical steps in its amendments and solutions, adjusting or replacing the elements that were prone to abuse and a cause of the BEPS practices it sought to prevent, for instance with the removal of the automatic application of independent status to general commission agents and brokers[647].

In this sense, Action 7 resisted the urge to reformulate entirely the independent agent status' provision, contrary to what appears at first glance. With effect, Action 7's proposed solution does not include substantial modification to article 5 (6)

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644 MONSENEGO, Jérôme – *The Independent Agent*… p. 956; EISENBEISS, Justus – *BEPS Action 7…* p. 489.
645 MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 191.
646 MONSENEGO, Jérôme – *The Independent Agent*… p. 951.
647 PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 444; GARBARINO, Carlo – *Permanent Establishments and*… p. 378; GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… p. 38.

OECDMC vis-à-vis agents that are not closely related to their principal, as the independence and ordinary course test remain almost identical[648].

Nevertheless, Action 7's solution's synergies also clarified some aspects that were problematic under the 2014 version, such as that the ordinary course test exclusively refers to the agent's business as an agent, with proper context, which is particularly relevant under this solution, since, for the assessment of the almost exclusivity criterion regarding the agent's activities on behalf of closely related enterprises, this test is essential[649].

Action 7's proposed solution would be effective in eliminating the cause of the BEPS practices addressed, which was supported by the subjectivity of the independence test and the lack of a decisive factor in its assessment.

This solution targets the subjectivity exploited by MNEs with closely related enterprises operating in almost exclusivity as their agents and removes the independence test's subjective element in the Commentary, turning this test into an objective presumption in the provision's wording, under which those arrangements would be barred from the independent agent status[650].

Action 7 designed not only an accurate solution but also a well-measured one, as its scope is limited to the arrangements where the agent acts in almost exclusivity on behalf of its closely related principal, leaving the remainder agents subject to the same tests and criteria as before, with slight improvements[651].

Additionally, taking on the synergies from other BEPS practices, paragraph (b)'s presumption will apply even if the original principal fragments its activities into several related principals, all of which controlled by the same person and engaging the same related agent, thus barring MNEs from artificially fragmenting their business to nullify this provision by aggregating that agent's principals[652]. In this

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[648] KAROLYI, Balazs – *The Challenges of*… p. 41; MONSENEGO, Jérôme – *The Independent Agent*… p. 951.
[649] GARBARINO, Carlo – *Permanent Establishments and*… p. 378; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 303; OECD – *Preventing the Artificial*… pp. 25-26; EISENBEISS, Justus – *BEPS Action 7…* p. 489.
[650] KAROLYI, Balazs – *The Challenges of*… p. 41; CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 10-12.
[651] MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 180-181.
[652] CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 506; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 191.

sense, paragraph (b) also dons an anti-fragmentation rule, on top of the objective presumption.

Furthermore, paragraph (b) also deserves praise for its function as an equitable provision that provides for a more neutral treatment between related persons and truly independent persons, as under the robes of an anti-avoidance provision it creates a new levelled playing field, one in which it is substantially difficult for group companies to take advantage of their group relations to secure a more advantageous position than those of truly independent persons, which also increases legal certainty for the independent agent status with their automatic exclusion[653].

On this note, it is clear that Action 7's proposed amendments target and affect group membership vis-à-vis the independent agent status, expunging some of the inherent advantages of a group relation, which causes a significant shift in group membership's benefits since under these amendments it becomes a badge for the inability to qualify for the independent agent status, hence interest shifts from group membership to true independence[654].

Through such an approach, Action 7 nullifies MNE's strategies designed around the use of related persons, what was once a source of their success has become a source for their demise. Yet, this penalization of groups may trigger unwanted economic effects, which are not without critique[655].

The proposed safe harbour for early stages businesses, such as start-up companies, an increasingly common presence in the current economy, deserves praise as they may still be entitled to the independent agent status despite the typical apparent dependence vis-à-vis a principal in early stages, by resorting to a comprehensive assessment based on all facts and circumstances, but only if for a short period of time[656].

Based on the purpose and intention of this proposed measure, we reckon that it should also apply not only to early stages businesses, but to other temporary, unique

[653] MONSENEGO, Jérôme – *The Independent Agent*… p. 956; GILLESPIE, John – *The Base Erosion*… p. 47.
[654] EISENBEISS, Justus – *BEPS Action 7…* p. 493; MONSENEGO, Jérôme – *The Independent Agent*… pp. 945, 956-959; GILLESPIE, John – *The Base Erosion*… p. 47.
[655] EISENBEISS, Justus – *BEPS Action 7…* p. 493; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 191.
[656] DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 307.

and business-proper situations, contingent on all facts and circumstances surrounding that business, such as those arising from a calamity or a crisis, where an agent might be temporarily limited to one principal, and perhaps even to seasonal businesses, such as the agricultural or fisheries[657].

Despite the noteworthy elements, we find that certain aspects of Action 7's proposed solution fell on the wrong side of the coin flip, deserving critique and to be questioned on their introduction, hopefully leading to improvement before implementation.

The new concept "closely related" is one of such elements, standing out amongst scholars and commentators as the odd element of Action 7's proposed solution for article 5 (6) 2014 OECDMC, with many questioning the reasoning and need behind its introduction, especially considering the similarity between it and the "associated enterprises" concept in article 9 2014 OECDMC[658].

Although differences can be found between this concept and the "associated enterprises" concept, they are much too thin and prone to overlapping, even causing Action 7 to take action to determine that both concepts are to be distinguished. Despite the slim differences between both concepts, rather unnoticeable at first sight, upon careful analysis, it is clear that the new concept is narrower than the "associated enterprises" concept, encapsulating fewer situations, hence implying closer connections between enterprises[659].

Considering these aspects, we find questionable the introduction of this novel alien concept, and even more so when the Commentary and guidance on this new concept are scarce[660]. With such similar concepts, both tax administration and taxpayers will suffer from the doubts arising from it, leading to legal uncertainty and potential disputes.

Notwithstanding, we acknowledge the merits of this new concept in operating a limitation to the presumptions and smoothing their application, however, this concept was incorporated in Action 7's proposed solution orphaned of proper

[657] MONSENEGO, Jérôme – *The Independent Agent*… p. 952.
[658] EISENBEISS, Justus – *BEPS Action 7…* pp. 488-489; MONSENEGO, Jérôme – *The Independent Agent*… p. 954.
[659] MONSENEGO, Jérôme – *The Independent Agent*… pp. 954-955.
[660] MONSENEGO, Jérôme – *The Independent Agent*… p. 955; GILLESPIE, John – *The Base Erosion*… p. 48.

context and reasoning, especially vis-à-vis the "associated enterprises" concept, both required and expected when introducing significant changes[661].

Further to paragraph (b), we highlight that in the first part of this provision, Action 7 proposes a notion of control based on all facts and circumstances, a flexibility that allows it to comprise cases that could remain below the fixed threshold of the closely related presumption, thus possibly preventing avoidance strategies designed to not fulfil the notion of control required to be considered a person closely related by artificially remaining below the 50% threshold but that still maintain the control through other legal instruments.

However, despite the merits of subjective concepts, Action 7 resorted to the questionable use of loose subjectivity in a key element, causing uncertainty and potential disputes, instead, the proposed provision and its Commentary should include defined boundaries refraining its subjectivity but still keeping the anti-avoidance purpose[662].

Continuing with this concept, we encounter another dubious element in the 10%/90% threshold proposed in the Commentary to supposedly clarify the exclusivity or almost exclusivity criterion vis-à-vis the agent's activity on behalf of closely related enterprises. Action 7 embraced this threshold as an example of the almost exclusivity criterion, attempting to clarify it, however, objective reasoning for this threshold has not been found, leaving an apparently arbitrary and questionable 10% threshold[663].

Even though we find the 10% threshold suitable as evidence of significant agent activity, in the sense that it may set aside the dependence presumption where unrelated agency activities surpass such threshold, and there is some support for its choice, Action 7 has not presented it or any clarification for this criterion or the example where it is presented, leaving unanswered questions, such as why 10% and not 15% or 9%; or why does the example focus on sales; or even if this example is

[661] CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 506; GILLESPIE, John – *The Base Erosion*… p. 48.
[662] GILLESPIE, John – *The Base Erosion*… p. 48.
[663] MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 191-192.

meant to introduce a criterion for independence or is it a simple indicator that can be rebutted based on other elements, based on all facts and circumstances[664].

The apparent clarifying purpose of that threshold seems to have caused the opposite effect, leaving greater uncertainty over the independence test and the dependence presumption, leading to disputes in domestic courts and disparities in this element's interpretation[665].

Once again, the greatest critique to this solution is the most common throughout Action 7, the lack of proper and detailed guidance on the proposed amendments, especially for new subjective concepts and criteria, as well as on examples that do not provide decisive orientations, for instance, sales are proposed as a mere example, meaning that other benchmark could be used to measure the grade of exclusivity of the agent, leading to divergent country practices[666].

Having completed the core critiques on this solution, we conclude our analysis with a structural critique on Action 7's proposed article 5 (6) (b) OECDMC that also encompasses the other Action 7's solutions.

It is our view that keeping a relevant cross-sectional provision such as the definition of closely related, as a paragraph of article 5 (6) OECDMC is inefficient, potentially misleading and structurally incorrect within article 5 OECDMC, instead, we reckon that this concept's definition should be vested with an autonomous number within article 5 OECDMC, enforcing its relevance and independence from all articles, especially if accompanied by proper guidance.

We hereby conclude our analysis on Action 7's proposed solution for the third BEPS strategy's second feature regarding the independent agent status, having exposed both its positive and negative aspects, our assessment remains that the proposed solution is suitable to reach Action7's objective and return the independent agent status to its former self, the true independent *bonafide* agent, nonetheless, it needs improvements before its implementation.

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[664] *Ibid*; MONSENEGO, Jérôme – *The Independent Agent*… pp. 952-953; PLEIJSIER, Arthur – *The Artificial Avoidance*… pp. 444-445.

[665] MONSENEGO, Jérôme – *The Independent Agent*… p. 953; PLEIJSIER, Arthur – *The Artificial Avoidance*… p. 445; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 191-192.

[666] MONSENEGO, Jérôme – *The Independent Agent*… pp. 952-953, 955; EISENBEISS, Justus – *BEPS Action 7…* pp. 489, 497; PROXENOS, Jolani – *An analysis of*… p. 41; GILLESPIE, John – *The Base Erosion*… p. 48; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 180-181.

Notwithstanding, each of Action 7's proposed solutions for the third BEPS strategy's features are part of a unified strategy to prevent BEPS practices connected with the DAPE concept, therefore, they require a combined analysis as a single strategy against these practices.

From our comments on both proposed solutions, it is evident that the combined outcome of Action 7's proposed solution for the third BEPS strategy is a substantially lower threshold for the DAPE concept through the joint efforts of augmenting the scope of article 5 (5) OECDMC and reducing article 5 (6) OECDMC's scope[667].

These combined efforts succeed in flipping the *status quo* on MNEs commissionaire arrangements, as these cease from being the definition of an independent agent to become the definition of a dependent agent whenever acting for closely related enterprises, which they often do, revealing the success sought with this concept's policy change[668].

Even though Action 7's proposed solution for article 5 (6) OECDMC is not a deeming provision, its practical outcome, together with the ones on article 5 (5) OECDMC, on commissionaire arrangements is that the DAPE status would become almost inevitable for MNEs[669].

With effect, this solution completes the tactic designed against the third BEPS strategy, by preventing MNEs from seeking refuge in article 5 (6) OECDMC's safe harbour, hence Action 7 provides an enforced solution against this strategy through an overall broader DAPE concept[670].

Despite the apparent successful path that could arise from Action 7's solution against this third BEPS strategy, we reckon that the combined solutions also augment their negative elements, especially those connected with their subjectivity and uncertainty together with the lack of proper guidance in an overbearing disproportionate solution with an exceedingly wide scope, resulting in a near-

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667 MONSENEGO, Jérôme – *The Independent Agent*… pp. 956, 958; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 307; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 170.

668 KAROLYI, Balazs – *The Challenges of*… p. 42; TRACANA, Dinis –*The Effect of*… p. 215; EISENBEISS, Justus – *BEPS Action 7…* p. 489.

669 MONSENEGO, Jérôme – *The Independent Agent*… p. 956; EISENBEISS, Justus – *BEPS Action 7…* p. 489.

670 MONSENEGO, Jérôme – *The Independent Agent*… p. 956; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 307; KAROLYI, Balazs – *The Challenges of*… p. 42.

presumption for MNEs' cross-border activities within the DAPE context, which should be not be left unchained[671].

Therefore, and despite the positive features arising from the combined tactic, we still reckon that Action 7's solution against the third BEPS strategy should be revised prior to its implementation, as the outcome of the adoption of this proposed solution could prove to be detrimental over Action 7's purpose and objectives for the DAPE concept.

Although the combination of both solutions intensifies their positive elements, the resulting negative aspects still tip the scale in favour of the need to improve, as the DAPE threshold would be set too low with an over-expanded concept, undesirably exceeding the fundamental purposes of Action 7 and the BEPS project by going disproportionately beyond artificial arrangements and possibly impacting genuine arrangements.

In this sense, Action 7's solution against the third BEPS strategy's final assessment is that it results in a gluttonous provision in need of a diet so as to not cripple the DAPE concept and cross-border activities, the basis of the current global economy. Reinforced tax administrations pursuing taxpayers, with and without artificial arrangements, could encourage the latter to develop new avoidance strategies, twisting Action 7's purpose.

At this point, we concluded our analysis on Action 7's solution against the third BEPS strategy, having exposed the causes and practices that led to and fostered this strategy, as well as presented and analysed Action 7's recommended changes to stop and prevent it, resulting in an unfortunate disproportionate set of measures, short of what Action 7could, and should, have proposed.

This marks the end of our analysis on Action 7's various proposed amendments to article 5 2014 OECDMC to combat the three BEPS strategies addressed throughout this section, which seek the termination and prevention of these strategies from continuing to shift taxation out of source countries or eluding taxation completely through artificial arrangements and the exploitation of loopholes and divergent practices.

[671] MONSENEGO, Jérôme – *The Independent Agent*… pp. 957-959.

2.4. Action 7's outcome

With our dive onto the depths of Action 7 complete, in which we identified the causes and practices of common BEPS strategies implemented to circumvent PE status and deviate taxation from source countries, as well as explained and analysed the proposed amendments to cease and prevent such strategies and practices from succeeding in their goals, it is the moment to arise from such depths and place Action 7 into perspective to assess it in an overview of the proposed solutions.

Our assessment of Action 7's outcome considers its proposed amendments in light of the purposes and objectives that presided over its development by the OECD, to prevent the artificial avoidance of PE status by upgrading the international standards on the allocation of taxing rights that reside at the heart of this concept, nullifying common specific strategies[672]. Still, there are further aspects in this concept that need an upgrade and that were not addressed in Action 7.

Our analysis above revealed that Action 7's flavour lies in lowering the PE status' threshold based on a two-pronged approach against the MNEs' strategies exploiting the 2014 PE concept's shortcomings, as it greatly expands the PE concept's scope at the same time it limits the ability to claim refuge in its exceptions.

Globally, Action 7 stayed fairly true to its initial purposes and objectives, the proposed amendments would effectively lower the PE status' threshold and catch in its wider net the practices MNEs carried out to prevent PE status and source taxation (or lower it).

However, as noted, Action 7 collected too many flaws and shortcomings throughout the proposed amendments to article 5 2014 OECDMC that preclude it from the necessary success of such an endeavour, namely on the lack of proper guidance and clarity on new provisions, together with a low and disproportionate threshold[673].

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[672] OECD – *Preventing the Artificial*… pp. 9, 13-14.
[673] PANAYI, Christiana HJI – *International Tax Law*… p. 641; BRAUNER, Yariv – *Treaties in the*… p. 1008; CUNNINGHAM, Kevin – *The Post-BEPS World*… p. 510; WETTERSTEN, Maria – *How can the*… pp. 26-27.

Despite its flaws and our suggested improvements before implementation, Action 7 embodies a new international standard for the PE concept, an expected stronger concept less permeable to MNEs' avoidance actions and capable of continuing to endure the test of time without losing relevance and applicability within the international taxation system.

With a new international standard, it is expectable that tax administrations and taxpayers go through a significant adjustment period following this taxation tremor, in which they both have to reshape their action/business plans and strategies to the new *status quo*, however, if Action 7 had provided proper guidance and clarity to the international taxation system's stakeholders, this adjustment period would be less extensive and with fewer quarrels[674].

On Action 7 itself, contrary to the BEPS Project's initial desire, we find that it took a pragmatic approach to the international taxation standards' deficiencies, based on a short selection of targets and focused on clarifications of the true intent of the PE concepts, together with a new policy for the DAPE concept[675].

Action 7 fell short of true innovation and revolution on its solutions for the problems identified in the initial reports, as the solutions presented could rather be seen as an ensemble of previous works from working parties and commissions, and the collection of existing practices and inspirations from the UNMC, in a nutshell, its outcome could have been the result of OECD's regular activity, albeit the consensus and acceptance could be less significant[676].

Despite the supposed concern with collateral damages from Action 7's solutions, we reckon that such concern remained as a simple idea that only timidly left the blueprints into the final deliverable[677].

As mentioned throughout our analysis, Action 7 did not properly consider the spillover effects of its solutions, namely with overbearing and excessively wide measures that would drive the PE threshold too low, enabling persecutory actions

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[674] CUNNINGHAM, Kevin – *The Post-BEPS World*… pp. 504, 510; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 240.
[675] BRAUNER, Yariv – *Treaties in the…* p. 1008; DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… p. 311; PANAYI, Christiana HJI – *International Tax Law*… p. 628.
[676] GONZÁLEZ-BARREDA, Pablo A. Hernández – *A Historical Analysis*… pp. 289-290, 292; BETTEN, Rijkele; NAOUM, Monia – *Chapter 2: Permanent…* p. 15; MONSENEGO, Jérôme – *The Independent Agent*… pp. 945, 951; KOSTIC, Svetislav V. – *Chapter 3: New*… p. 8.
[677] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… pp. 236-237.

from tax administrations on taxpayers carrying out cross-border endeavours absent of any artificial tax avoidance motivation[678].

Although reinforced actions from tax administrations against BEPS practices should be expected following Action 7, and rightfully so, such actions should still be guided by proportionality and equity principles, in line with international standards and abstaining from potentially hindering the global economy, cross-border trade and business initiative, so as not to target sound endeavours[679].

It could also be argued that Action 7 failed its core purpose of an encompassing solution based on wide consensus since the so-called consensus relies on options and choices for each country to implement some of the proposed solutions, repeating past errors of enabling and fostering divergent country practices, a cause of BEPS practices[680].

Despite the numerous deficiencies and need for improvement, Action 7 still deserves commendation for providing suitable solutions against BEPS practices and the likely increase of source taxation from cross-border activities with a significant local presence, thus returning taxation to where it should be had it not been previously shifted or significantly reduced, which is a particularly relevant aspect for developing countries, however, we highlight that this commendation hinges on the effective verification of higher source taxation[681].

With effect, Action 7's actual worth will only arise from effective implementation and adoption of the proposed solutions (be it as hard law in DTTs, or soft law in the OECDMC), otherwise, it is a mere soft law research report[682].

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[678] PISTONE, Pasquale – *Chapter 1: General*… p. 4; KAROLYI, Balazs – *The Challenges of*… pp. 62-63; EISENBEISS, Justus – *BEPS Action 7…* pp. 494, 497.
[679] GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 36-37; KAROLYI, Balazs – *The Challenges of*… pp. 62-63; EISENBEISS, Justus – *BEPS Action 7…* p. 494; WETTERSTEN, Maria – *How can the*… pp. 26-28.
[680] PANAYI, Christiana HJI – *International Tax Law*… pp. 655, 658; GONZÁLEZ-BARREDA, Pablo A. Hernández – *A Historical Analysis*… p. 291; ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… pp. 30-31.
[681] GOUVEIA, Ana Cláudia Andrade – *O Estabelecimento Estável*… pp. 34, 36-37; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… pp. 237, 240-241; EISENBEISS, Justus – *BEPS Action 7…* p. 494.
[682] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… pp. 237, 241; PISTONE, Pasquale – *Chapter 1: General*… p. 1; LIEBMAN, Howard M. – *Chapter 11: Base*… p. 10.

2.4.1. Initial Acceptance and implementation

To complete the assessment on Action 7, we will address the international community's acceptance of its solutions within domestic law and DTTs. By gauging Action 7's initial implementation upon its release, it may be possible to extrapolate its potential impact within the international taxation system as a new international standard for the PE concept.

In this context, and within the BEPS Project, Action 15 is expected to play a fundamental role in the swift and harmonious global implementation of Action 7's proposed solutions. However, we found that consensus and coordinated action in the implementation of Action 7's proposed solutions was not as widespread as it would be expected.

Albeit Action 7 could be an unrefined solution or a first sketch, some countries embraced the spirit and ideas of the reports and opted to pre-emptively strike the artificial avoidance of PE status and the shifting of profits from where there is a relevant presence, some even before the delivery of the final report, including Australia, Greece, Hungary and the UK [683].

Within the countries adopting such behaviour, the UK stands out with its 2015 Diverted Profit Tax, a special purpose tax devoted to targeting MNEs with a significant local presence that, through artificial mechanisms, managed to divert UK-based profits to another jurisdiction, notably to one with a more friendly tax regime, by avoiding PE status[684].

Action 7's influence in this measure is uncanny, albeit it begs the question if it suffers from the same illness as Action 7, *i.e.* the absence of concern for side-effects, in this case, the double taxation arising from the absence of relief from DTTs.

Despite some countries' precocious actions, generally, the international community accepted Action 7's solutions in their bilateral DTTs, with some changing

[683] PANAYI, Christiana HJI – *International Tax Law*… pp. 658-689; BETTEN, Rijkele; NAOUM, Monia – *Chapter 2: Permanent…* p. 15; EISENBEISS, Justus – *BEPS Action 7…* p. 495; HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 38; MAURER, Ludmilla [et. al.] – *A Brave New Post-BEPS World: New Double Tax Treaty Between Germany and Australia Implements BEPS Measures*. Intertax. Volume 45, issue 4 (2017) pp. 310, 312.

[684] PANAYI, Christiana HJI – *International Tax Law*… pp. 658-659; EISENBEISS, Justus – *BEPS Action 7…* pp. 495-496; BARBIER, Casper – *The Permanent Establishment*… pp. 68-69.

their traditional stance on tax competitiveness, like the Netherlands, while others got cold feet in the last stretch and refrained from a full-fledged endorsement, like the USA[685].

On this note, we highlight the 2016 DTT between Germany and Australia, which was one of the first DTTs to embrace Action 7's solutions, and even went beyond them, setting the tone for other countries[686].

As expected, the majority of OECD countries embraced Action 7 and led the global movement for its acceptance, however, they were not the only ones, as non-OECD countries and developing countries (although to a substantially lower degree) also adopted it[687].

In this sense, we highlight the EU's conduct on Action 7's initial acceptance and implementation, as in January 2016 the European Commission issued a Recommendation encouraging Member-States to adopt and implement Action 7's solutions on their bilateral DTTs to prevent the artificial avoidance of PE status, to maintain the integrity and sound functioning of the internal market and prevent mismatches and distortions[688].

Despite the calls for reform and improvement, there seems to exist some level of consensus and acceptance around Action 7's solutions for article 5 OECDMC, therefore the focus should be geared towards its effective implementation.

Action 7's coordinated and swift implementation could, and should, trigger behavioural changes in MNEs and an increase in tax collection, or at least this is what is expected from Action 7, and it may effectively occur[689].

However, should unilateral measures similar to the Diverted Profit Tax proliferate (the exact opposite of the BEPS Project's objectives), Action 7's efforts will undoubtedly be further diminished, as uncoordinated action often leads to

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685 PISTONE, Pasquale – *Chapter 1: General*… pp. 3-4, 10; EISENBEISS, Justus – *BEPS Action 7…* p. 495.
686 MAURER, Ludmilla [et. al.] – *A Brave New*… pp. 310, 314-318.
687 PISTONE, Pasquale – *Chapter 1: General*… pp. 10-11; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 236; EISENBEISS, Justus – *BEPS Action 7…* p. 497.
688 EU – Commission Recommendation (EU) 2016/136 of 28 January 2016 on the implementation of measures against tax treaty abuse. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32016H0136; DOURADO, Ana Paula – *Governação Fiscal Global*… pp. 101-105.
689 LIEBMAN, Howard M. – *Chapter 11: Base*… p. 10; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… pp. 237, 240-241.

double taxation and artificial avoidance, ultimately hindering cross-border economic business[690].

Therefore, it becomes clear that Action 7's success lies with the effective and correct implementation of its proposed solutions amongst all stakeholders, an implementation which should occur in a swift and coordinated fashion to avoid the loopholes and mismatches that caused BEPS practices initially[691].

In Portugal, although a country in the forefront of the BEPS Project and an EU Member-State, Action 7's implementation within its domestic system was very shy, as there was no modification to the PE domestic concept[692] in the years following its release (and until 2021), and it was only possible to observe a glimpse of Action 7's influence in four of the Portuguese DTTs following its delivery, namely those with Oman, Saudi Arabia, Senegal and Vietnam[693].

Together with implementation, monitoring the exact measures adopted by each country and their effects on taxpayers and tax collection needs to be the BEPS Project's main focus moving forward, using the data collected to address and reform the aspects that are cause for concern, some of which addressed herein[694]. The BEPS Project will become an ongoing development to improve the international taxation system and prevent artificial avoidance.

Notwithstanding, as expected, Action 7's acceptance and implementation will go beyond countries and domestic systems, since the OECD will update its Model Convention accordingly, hopefully improving the proposed solutions before releasing the new OECDMC and taking the opportunity to address the concerns raised in Chapter 1 and that were absent in Action 7.

Further to the swift and coordinated implementation of Action 7's measures, one of the BEPS Project's tasks was the designing and delivery of a mechanism that could aggregate the various treaty-related solutions and allow for a harmonious and

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[690] EISENBEISS, Justus – *BEPS Action 7…* pp. 496-497; HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 37.
[691] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 241.
[692] Article 5 of the Portuguese Corporate Income Tax Code.
[693] At the time this thesis was concluded, only the Portugal-Angola DTT was compliant with the BEPS Project.
[694] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 241.

accelerated modification of all DTTs, instead of lengthy bilateral negotiations of all DTTs.

This task was bestowed upon Action 15[695], which culminated in 2016 with the delivery of the Multilateral Instrument. Since Action 7 is dedicated to treaty-related matters, its solutions were included within the MLI to foster their swift and harmonious implementation across the global DTT network[696].

We have completed our critical analysis on Action 7 and the solutions proposed for upgrading article 5 OECDMC and prevent the artificial avoidance of PE status.

2.5. Preliminary conclusions

With the closing curtain on this Chapter, some preliminary conclusions can be drawn from our assessment on the BEPS Project's Action 7 and its proposed solutions to prevent the artificial avoidance of PE status.

The BEPS Project was a landmark venture with unparalleled support from all quadrants of the international taxation panorama, encouraged and nourished by countries and international organizations alike.

The importance and relevance of the BEPS Project have not subsided, it continues to carry out a crucial part of its purpose with the continuous monitoring of the international taxation system in light of its Action Plan and the pace of implementation of the proposed solutions.

The holistic work conducted by the various branches of the BEPS Project has made the international taxation system more robust, directly tackling its frail and exploitable elements to restore trust, security and perhaps more equity to the international taxation system in society's eyes.

The objectives of the BEPS Project are unquestionably commendable, however, its deliverables and continuous work must rise to the occasion and march steadily in front of the success that came from the unique global support behind this venture

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[695] OECD – *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15 – 2015 Final Report*. OECD/G20 Base Erosion and Profit Shifting Project. OECD Publishing. Paris, 2015. Available at: http://dx.doi.org/10.1787/9789264241688-en

[696] GARBARINO, Carlo – *Permanent Establishments and*… p. 365.

and unexpected wide consensus on some of its key features (although not the desired absolute consensus).

Although more could have been done with this venture, for instance on the challenges arising from the digital economy, on the transfer pricing concept or the level of minimum standards embraced; it still has accomplished plenty and this first prototype of a broad-based reform of the international taxation system has proven that a global united taxation reform is possible. Perhaps this endeavour's greatest medal is the proof of concept made.

The BEPS Project succeeded in shedding light on the importance and global impact of BEPS, as a disease that knows no allies and has a global reach, being particularly fond of low tax jurisdictions to rest profits, mainly arising from high tax jurisdictions, be them developed or developing countries, hence rallying foes from all quadrants.

Consequently, the leading players and instigators of these practices were also brought into the spotlight, leading to scrutiny and investigation of their practices aiming at further equity to the international taxation system, with effective taxation where profits reside and value is created. Such actions also fostered enhanced cooperation between countries (as opposed to tax competition) and the disclosure of aggressive tax strategies by those involved.

Unfortunately, although polemic, the aftermath of the BEPS Project led to a feral sense of morality against the international taxation system that could be prejudicial and harm its core. Although aggressive and artificial tax planning strategies should be fought, such goal should not lose its north and spiral onto legitimate and sound tax planning strategies, if it is true that those with capacity should be taxed accordingly, it is also true that it is their right to be fairly taxed and seek the lawful benefits and regimes made available, *i.e.* a right to legitimate tax planning, without morality concerns, which became even more possible with globalization[697]. Although taxpayers have a duty to pay taxes, this does not extend to a tip.

[697] DOURADO, Ana Paula – *Direito Fiscal*… pp. 292-293; SANCHES, J. L. Saldanha – *Manual de Direito*… pp. 157-158; COURINHA, Gustavo Lopes – *Estudos de Direito*…. pp. 292-293; PIRES, Rita Calçada – *Manual de Direito*… p. 43; LANKHORST, Paul; VAN DAM, Harmen – *Post-BEPS Tax Advisory*… p. 73.

The BEPS Project has become a standard on international taxation, with increased substance, coherence and transparency as its banner. It shook a system that was in dire need of a tremor and successfully laid down the cornerstone to an improved and sturdier international taxation system.

The scrutiny and analysis over this project aided it to improve and carry out its purpose more swiftly, making sure it can achieve its goals. As stated, its work has not ended, and that same level of scrutiny and analysis must be present in its ongoing work with the Inclusive Framework and the future endeavours, such as Pillar One and Pillar Two.

Albeit the BEPS Project established from the start that its work would respect and complement the existing international taxation system's principles and standards, we find that a deeper discussion should be initiated on this matter and with the same level of support.

The continuous level of development of the world's economy does not allow for static modifications to the international taxation system and dogmas, a dynamic and constant approach is required, and even dogmas need to be questioned.

Regarding Action 7, we note that it failed to accompany the BEPS Project in its purpose of a holistic approach to enhance and improve the international taxation standards, in this case, the PE concept. Although that approach could be Action 7's initial purpose, the deliverable has proven that the OECD was obliged to refrain from such a goal, considering the lack of support and consensus to pursue it.

In this sense, the causes of Action 7's shortcoming on its scope showcases some of the fragility that is at the heart of the final deliverable, a lack of consensus to combat artificial avoidance of certain practices, which led to overcompensating provisions on other practices. The result is an unbalanced solution for a serious illness that deserved further concern and attention from stakeholders.

As stated at the end of Chapter 1, there is plenty to address when seeking to improve the PE concept and Action 7 only tackled a portion of it, falling short of what could be expected from an attempt to enhance this concept. Nevertheless, Action 7's surgical work is still a relevant breakthrough within the PE concept.

From our work, it stands clear that Action 7 shook the foundations of the international taxation system, specifically of the PE concept, this noticeable quake

caused several after-shocks with similar magnitude, remaining the doubt of whether these have ceased or will continue in the future.

Our analysis on Action 7's solutions sought to assess and evaluate each solution based on its raw virtues and defects before being tainted by their implementation into DTTs, Model Conventions or domestic law, considering that their implementation will not impair the validity of our findings despite being soft-law.

In this sense, our initial task was to present the causes and practices that lead to the artificial avoidance of PE status to provide context for Action 7's solutions.

As a result, we found that MNEs were allowed to develop and implement BEPS practices due to the lethargy of stakeholders (countries and organizations alike) to combat those practices and accompany the global economy's scientific and technological developments, together with the absence of a joint common notion of care over the international taxation system and awareness of the greater good that arises from combined efforts, and not unilateralism.

With this fertile ground, MNEs succeeded in growing intricate practices and strategies that resulted in the artificial avoidance of PE status and preventing or lowering, source taxation over their cross-border ventures, thus lowering their overall tax burden and increasing their profits.

It is with this background that Action 7 delivers its final report with proposed solutions to render ineffective the MNEs' BEPS practices and to prevent the artificial avoidance of PE status and restore source taxation.

In our critical analysis, we exposed the proposed solutions and valued their merits and weaknesses, portraying the consequences that could arise should they be implemented as presented in the final report, calling for reform when needed. Regrettably, Action 7's solutions were, and continue to be, implemented without significant modifications, therefore the concerns raised herein are likely to verify.

Action 7's solutions have become hard law through unilateral measures onto countries' domestic law, through bilateral measures in individual DTTs, and through multilateral measures via the MLI. Action 7 has also been embraced in the OECDMC's latest updated version.

Despite the level of Action 7's implementation, our routes to modify and enhance its solutions may still be adopted to improve the current rules and halt the damages to the international taxation system and the PE concept.

Moving along to Action 7's concrete solutions, the first solution analysed dealt with the least relevant BEPS practice within Action 7's context, yet, despite some aspects, we find this to be its best solution.

With effect, this solution could effectively target and prevent MNEs' splitting practices in relation to the project PE concept. It is an example of precision work that has the capability of producing high results, however, its impact would be more substantial if it had been made through an amendment to the provision's wording, similar to the anti-fragmentation rule.

In this sense, article 5 (3) OECDMC's proposed anti-splitting rule should be effectively inserted in DTTs, and not relegated to the Commentary at each country's discretion. We find that with this insertion, Action 7's solution could effectively prevent the artificial avoidance of PE status through the splitting-up of contracts and achieve greater legal certainty.

It stands clear that Action 7 failed its goal of a unified and coordinated front against BEPS practices since it presents this solution as an optional add-on feature for countries to adopt if they see fit. This is a clear example of future divergent country practices that could lead to new BEPS practices; therefore, the optional element should be expunged from this solution.

On article 5 (3) OECDMC and its new anti-splitting provision, Action 7 deserves praise for choosing to salvage and boost the existing rule on subcontractors, however, it could have clarified if, under the new rule, its anti-abusive purpose will bring it closer to a deeming provision based on the 12-month threshold for the enterprises with shorter activities, or the *tempus* test still has some relevance.

We reckon that considering its anti-abusive purpose, this provision ought to give rise to project PEs for all closely related enterprises engaged in connected activities in the same site, even if, for example, the relevant enterprise only executes its activity for two months, contingent on the verification of the remaining tests.

Regarding article 5 (4) OECDMC, Action 7's solution reveals a shift in OECD's understanding and interpretation of this article, from a formal/legal approach to a

factual/economic approach on the preparatory or auxiliary activities and how they relate and are integrated into MNEs' businesses activities.

Furthermore, considering that the shift in this provision intends to prevent divergent country practices and remove doubts on the nature of each of its paragraphs, clearly defining that all paragraphs are subject to the preparatory or auxiliary test and that there is no automatic verification for certain activities, we find questionable the choice to keep its initial paragraphs as examples.

The continued existence of paragraphs (a) to (d) could be ambiguous, leading to further debate and questions over their true nature, if mere examples or activities that automatically qualify for the exclusion of PE status, especially considering the shift in their interpretation, which could cause disputes. There is no need to keep illustrative examples in article 5 (4) OECDMC.

Alternatively, if there is the desire to maintain the illustrative examples, then those should be upgraded and brought to the XXI century, with examples that also encompass recent business models and the DAPE concept.

Our analysis makes clear that tax administrations will emerge stronger and reinforced to target and pursue taxpayers that have previously eluded PE status, which goes to this modification's purpose. However, the power bestowed upon tax administrations has not been limited, hence there is a risk of overbearing action by tax administrations claiming that any enterprise in cross-border ventures has reached PE status, passing along the burden of proof to the taxpayer to dismiss such qualification, if possible.

This solution has failed to consider the spillover effects that such actions cause, especially for smaller enterprises engaged in cross-border ventures, in relation to which that burden could be too heavy to bear, potentially causing those enterprises to refrain from or abandon cross-border ventures even though they would not reach the PE threshold, hence negatively impacting the global economy.

Once again, Action 7 provides extensive leeway to countries by granting an option to adopt this solution, diminishing its merits. This deserves criticism as it allows, and almost endorses, divergent country practices, one of the leading causes of BEPS practices. This uncovers Action 7's inability to reach a strong compromise

on the fight against BEPS and the artificial avoidance of PE status, which requires cooperation and coordination.

Still in article 5 (4) OECDMC, but advancing onto its new anti-fragmentation rule, we encounter Action 7's first unique solution, which overhauls this provision by setting a new standard on the preparatory or auxiliary activities exceptions.

This game-changing provision successfully addresses head-on MNEs' artificial avoidance practices that sought to prevent PE status in source countries, rendering them useless. This last stance anti-abuse technical solution prescribed by Action 7 against these practices deserves praise for maintaining the purpose and valour of article 5 (4) OECDMC. It introduces a holistic analysis of closely related enterprises' activities in source countries to safeguard the PE status' exceptions from exploitation.

Nonetheless, this very same holistic approach originates a concern on its spillover effects by grouping activities that do not have an artificial avoidance purpose. There may exist sound corporate and economic reasons to put forward a specific structuring for a cross-border venture, absent tax considerations.

However, by casting such a wide net with a lower PE threshold, those ventures could originate a PE due to this new rule, although there are legitimate, non-tax, reasons for their organization.

To refrain such blind crusade, complementary anti-abuse provisions should have been introduced within Action 7's solution to balance its effect, as per some solutions with direct reference to Action 6's work and the principal purpose test, absent any option.

Article 5 (4) OECDMC's scope went from too narrow that it allowed abusive and artificial practices to be implemented without the ability to counter them, to an overcompensating wide scope that targets all complementary activities that are part of a cohesive business operation, without a clear notion of what either concept exactly stands for, due to the lack of guidance.

We struggle to identify Action 7's concern with legal certainty and objectivity with the introduction of this solution, potential leading to chaos between tax administrations and taxpayers in disputes.

Still, the anti-fragmentation rule should prove itself as an efficient weapon to prevent the artificial avoidance of PE status via the fragmentation of activities through related enterprises.

In fact, we reckon that its cross-sectional application within article 5 OECDMC should be explicit, namely in article 5 (5) OECDMC when it refers to article 5 (4) OECDMC, as the benefits of its application could be considerable, conditional on certain adjustments.

Following this reference, we move onto the solutions in article 5 (5) OECDMC and the artificial avoidance of DAPE status. Action 7 successfully addressed the issue raised regarding the disparities between Civil Law and Common Law countries over this provision's interpretation, solving a fundamental aspect in the DAPE in an ingenious way that should satisfy both sides.

Our work revealed that Action 7's main, although we ponder if it was not the only, concern with this provision resided with commissionaire arrangements, as its solutions appear to be tailored to target those arrangements, which it found to be artificial and abusive by definition.

That qualification of all commissionaire arrangements goes beyond Action 7's purpose, it is highly questionable that such arrangements are inherently tax-driven and artificial, instead, Action 7 should have refrained its solutions to target tax-driven arrangements used to replace previous distributor arrangements.

There are genuine and sound business reasons to implement commissionaire structures, yet these are not even considered. There is a clear risk that this solution will hinder the international taxation system and cross-border business via such an overbearing and disproportionate measure.

Furthermore, it is surprising that LRDs operating with flash titles are not considered as artificial structures that should be fought in Action 7. Even though there is some source taxation from effective sales, it is clear that these arrangements use an abusive method to distort article 5 (5) OECDMC's purpose and reduce source taxation.

Following our analysis, flash title mechanisms' main purpose is to avoid PE status, hence perhaps Action 6 is more suited to target and combat this strategy, still, Action 7 could, and should, have taken a different stance on LRDs.

Even more considering that Action 7's solution against commissionaire arrangements can be easily nullified by MNEs by shifting their current commissionaire arrangements into LRDs under flash titles, which goes against Action 7's objectives.

Although the shift from commissionaire to LRD arrangements, would fulfil Action 7's purpose of restoring source taxation, tax collection-wise, it is doubtful whether that shift would be meaningful.

This anti-artificial avoidance solution should not be so easily circumvented. This solution would be more effective if it was effectively focused on artificial avoidance, as an anti-abuse provision, instead of simply targeting commissionaire arrangements and similar practices.

As per our analysis, the fault of Action 7's solution on the DAPE concept resides at its core, it sought to prevent artificial avoidance by driving the DAPE's threshold so low that it would be avoidance-proof, instead, Action 7 presented an overbearing and disproportionate solution with a scope too wide for its own benefit, potentially leading to a spike in PEs across the globe where they should not exist, for instance, good sales agents. Once again causing a heavy burden on tax administrations and taxpayers.

Furthermore, with such a low threshold, this provision could set off two worrying reactions. First, from countries that may find this solution to be disproportionate vis-à-vis its purpose and nature but also regarding the benefits it may provide in light of the increased burdens it has, hence some countries will not implement this solution, which gives rise to divergent country practices and loopholes.

Another reaction comes from MNEs, but also smaller international players, that due to such wide provisions, choose to refrain from international endeavours, hence negatively impacting the global economy, which will have a reflex in the countries' actions, pushing them further away from this measure's implementation. Action 7's solutions are not meant to create attritions on the global economy, instead, they should foster a more equitable and healthier global economy and trade with fairer taxation.

About the independent agent status, Action 7's solution offers a good and innovative solution that aims at restoring this status to its original glory, recouping the almost forgotten *bonafide* agent concept. This technical solution offers the correct means to effectively target and prevent artificial avoidance over article 5 (6) OECDMC, especially regarding groups. Its anti-abuse nature should reap significant results over MNEs' artificial group strategies.

However, Action 7 has left too many answered questions with this solution, some of which are particularly relevant, such as the reason for adopting a completely new concept when the OECDMC already has a similar one, or for adopting a 90%/10% criterion to attest the almost exclusivity of an agent. Beyond the answered questions, this solution also creates concern over the unrestrained subjectivity.

This solution on the independent agent status plays a pivotal role within Action 7, with multiple cross-references to the newly introduced "closely related" concept, and yet the level of detail and guidance provided for its correct interpretation and application is far too scarce to achieve a successful result.

Also, the notorious policy shift to embrace a subjective approach to potential PE situations, together with the lack of guidance, creates the perfect storm for court disputes and lack of support for this provision.

Considering this solution's valour within the new PE concept, we question the reasons for paragraph (b)'s insertion within article 5 (6) OECDMC, as it would be more suited for this provision to be included within article 5 OECDMC as a new standalone provision.

Even though there is some uniqueness to Action 7, it is noticeable an influence from the UNMC and a sense that, despite being a breakthrough work, the solutions offered could have emerged from OECD's regular work. Nevertheless, Action 7 offers a new standard to the PE concept, without modifying its core, as initially sought by the BEPS Project.

Action 7's worries with side-effects emerging from its solutions appear to be reduced to references to analysis based on all facts and circumstances, which is arguably insufficient, especially considering the level of spillover impacts revealed.

If in fact Action 7 had such concerns, a more strenuous work on the ramifications arising from its solutions should have been conducted before its release. Nevertheless, this work should still be conducted under the aegis of the Inclusive Framework.

Action 7's lack of guidance on the new provisions and concepts, and the unrestrained subjective approaches are appalling considering its relevance and impact in the international taxation system. To put it in elucidative terms, it is the equivalent of releasing new complex lifesaving equipment and its manual only includes the on/off button's instructions.

Such apathy leads to disputes over the depth of the solutions and their concepts, which harms the international taxation system, instead of improving it.

This apathy, paired with the increased burden placed on tax administrations and taxpayers on the PE status' assessment over the latter's cross-border activities, will lead to an increase in disputes and litigation given that differences will arise regarding what should constitute a PE.

If taken at face value without further consideration, Action 7's solutions could lead to an overbearing PE concept, which could hinder the global economy and trade, as it targets without mercy both sinners and saints.

Action 7 has succeeded in presenting solutions that will lower the PE threshold vis-à-vis article 5 2014 OECDMC and that are mostly capable of preventing artificial avoidance practices. Also, we note that some of the concerns raised in Chapter 1 were addressed in Action 7, notably on the DAPE.

One of the BEPS Project's key banners for the PE concept was that lowering the threshold would successfully prevent artificial avoidance, thus increasing the number of PEs and restore source taxation. This result is verified, as MNEs are already adapting their business strategies and restructuring their cross-border presence considering Action 7's solutions.

Under this prism, Action 7 could strike success, considering that its solutions are capable of substantially lowering the PE threshold.

However, as stressed, the excitement may have led Action 7 to overkill its objective, as the threshold has been set too low for this concept to keep on playing

its crucial role in the international taxation system. Even meaningless endeavours could be deemed to have a PE, which is not this concept's purpose nor its nature, not all activities entail a taxable nexus.

Albeit not a minimum standard, Action 7 still is among the BEPS Project's most critical elements, therefore more was expected and needed in terms of consensus-based harmonious solutions and guidance to improve and update the existing international standards.

Although we generally agree with most of the technical solutions presented, even if not perfect, the loopholes and multiples paths are detrimental to Action 7, the PE concept and the international taxation system.

Moreover, the uncertainty and disproportionality that arises from its solutions lead us to conclude that, overall, Action 7 is not eligible to fulfil its objectives, as it has failed to successfully balance legal certainty and the prevention of tax avoidance through subjective rules. In this sense, the anticipated heavier tax burden over MNEs becomes less justifiable as the necessary cost for an improved international taxation system.

However, Action 7 can still be salvaged from turning into a missed opportunity to improve and balance the international taxation system, all that is needed is the will to do it.

Being that Action 7's solutions are just soft law recommendations, which require implementation to become hard law, either domestically or in DTTs (on their own or through the MLI), its true success should be measured by its implementation. This will be the focus of the upcoming Chapters.

In the following Chapter, the implementation of Action 7's solutions as part of the MLI will be analysed, measuring the validity and similarities of the MLI's relevant articles vis-à-vis Action 7's solutions, and assessing whether there was improvement based on the concerns raised herein and its overall acceptance.

CHAPTER 3: THE PERMANENT ESTABLISHMENT CONCEPT AND THE MULTILATERAL INSTRUMENT – The BEPS Project's First Aftershock

In the preceding Chapter, we addressed the BEPS Project and Action 7's grand earthquake, the event that set off a series of echoes in the international taxation system and that is changing the existing *status quo* and moving onto a new paradigm, notably in the PE concept.

After the dust settled, it was clear that Action 7 began the construction of an improved PE concept, by reinforcing its foundation and building upon it. Action 7's recommendations are an indispensable asset for the PE concept's refurbishment, however, Action 7 is simply the blueprint, which requires effective execution to complete this endeavour.

Therefore, it stands to reason that Action 7 is a pivotal element in the PE concept's evolution and the cause of the aftershocks that succeeded it, some with greater impact than others.

Amongst the aftershocks, the MLI stands out as the first and primal instrument for the implementation of Action 7's recommendations into hard law, kick-starting the PE concept's upgrade.

The MLI is also a branch of the BEPS Project, originating from the ground-breaking work conducted under Action 15's aegis, which was entrusted with the task of assessing the feasibility of a multilateral treaty that would modify the existing DTTs following the BEPS Project's treaty-related recommendations, such as Action 7, thus swiftly streamlining their implementation across the globe[698].

As mentioned, one of the BEPS Project's main challenges resided with the implementation of the treaty-related proposals, since the bilateral negotiations of the over 3500 DTTs in existence would be a daunting and uncoordinated endeavour,

[698] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 240; BRAUNER, Yariv – *Treaties in the*… pp. 1019, 1030; PANAYI, Christiana HJI – *International Tax Law*… p. 645; OECD – *Explanatory Statement To The Multilateral Convention To Implement Tax Treaty Related Measures To Prevent Base Erosion And Profit Shifting* – OECD. 2016. p. 1. Available at: https://www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf.

likely to cause a stall, if not the abandonment, of the whole project[699]. In this sense, Action 15's conclusions, despite some apprehension, were the lifeline of the BEPS Project[700].

The work on the MLI commenced almost immediately after the release of Action 15's final report, with the *ad hoc* Group, so that it could be discussed and accepted by a significant share of the international taxation system's stakeholders, towards its signing and entry into force, thus embracing the momentum created[701].

While there have been other experiences with multilateral treaties in taxation, the MLI, due to its sheer magnitude and relevance, is a unique and cutting edge instrument that, albeit it is still in its early days, surrounded with plenty of discussions and divergences as to its value and application, still marks a crucial moment in the PE concept's evolution[702].

The MLI stands to modify the PE concept present in the DTT global network as per Action 7, or at least that is its ultimate goal.

Considering this thesis' focus, it is essential to assess the MLI's PE concept to evaluate if the work of the BEPS Project's *ad hoc* Group in this regard was reduced to a blind replication of Action 7's solutions or if these were improved prior to implementation.

This Chapter will be devoted to the MLI's PE concept and it will briefly address the origin of the MLI, its key features and relationship with DTTs, analyse its relevant articles, and concludes with its outcome.

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[699] PANAYI, Christiana HJI – *International Tax Law*… pp. 645-646; OECD – *Explanatory Statement To*… p. 1.
[700] BRAUNER, Yariv – *Treaties in the*… pp. 1019, 1030; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 241.
[701] PANAYI, Christiana HJI – *International Tax Law*… p. 646; OECD – *Explanatory Statement To*… pp. 1-2; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… p. 16.
[702] PANAYI, Christiana HJI – *The Compatibility of*… p. 111; KAROLYI, Balazs – *The Challenges of*… p. 51; MALHERBE, Jacques – *A New Tax Treaty for a new world: The Multilateral Convention to implement tax treaty-related measures to prevent base erosion and profit shifting*. Revista de Finanças Públicas e Direito Fiscal. Volume 11, number 1/2 (2018) p. 16; DOURADO, Ana Paula – *Governação Fiscal Global*… p. 27.

3.1. The Multilateral Instrument – overview

The MLI is a recent legal instrument, as its core elements were only disclosed by the OECD in 2016 and it only entered into force on July 1st, 2018[703], hence it is fair to state that the MLI is still an infant amongst international tax treaties.

As of September 2021, the MLI has 95 signatories (with four others expressing their intent to sign), and of those 65 have already ratified it. Over 2800 DTTs have been listed in notifications to the MLI by signatories and parties, covering over 1700 DTTs.

Although an infant, the MLI has already risen to the top as one of the most relevant international treaties in taxation, such distinction comes from its unique origin, construction, and functioning, as well as from its impact on the DTT global network.

Furthermore, despite the MLI's optional adhesion and of its content, the number of countries that have embraced it as signatories is striking, even more so considering its rather short life. In this regard, the BEPS Project's work should be congratulated, as the proud parents of an overachiever, however, there is more to the MLI than its acceptance.

Before analysing the MLI's implementation of Action 7's recommendations, it matters to quickly address the BEPS Project's initial work through Action 15, to better grasp the MLI's contours and the choices taken within it[704].

3.1.1. Inception

The BEPS Project is an unmistakably massive endeavour supported by the international community to target and prevent BEPS practices, eliminating double non-taxation and restore the balance between source and residence taxation.

[703] For the first group of countries that deposited their instruments of ratification, the MLI should have entered in effect on January 1st, 2019.
[704] The MLI is clearly a suitable subject for a thesis, however, this thesis's focus does reside with the MLI, therefore, our exposition of its particularities will be brief and only addressing the aspects essential for our work.

Overall, the BEPS Project should be regarded as successful, having multiple of its recommendations embraced and implemented by countries across the globe, already with some results to show, and created a turning point in international taxation by making possible multilateralism[705].

Nonetheless, the BEPS Project's success could be compromised if its recommendations are not implemented, if they are slowly and sparsely implemented, or even if they are to be implemented differently by each country, especially those referring to DTTs[706].

An uncoordinated and scarce implementation of these recommendations would provide MNEs with the time and space to learn and design new BEPS and tax avoidance strategies to circumvent such recommendations, which would render the BEPS Project useless since these newly developed strategies might stay under the radar for some time, thus perpetuating MNEs' BEPS practices and global tax loss[707].

The task of bilaterally renegotiating and adopting DTTs to implement the BEPS Project' recommendations does not pair with the required and pursued swift and synchronized implementation[708]. It became necessary to design an alternative to the traditional system of amending and revising DTTs that would meet the BEPS Project's implementation requirements[709].

This concern was included and addressed in the BEPS Project since its inception, by calling for quick and innovative solutions to surpass implementation difficulties that culminated in the development of a multilateral instrument[710].

Fast-forwarding from the initial report on BEPS, Action 15's final report clearly states the concerns that were at the heart of its proposal for a vessel capable of implementing the other Actions' treaty-related recommendations in a swift and

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[705] LIEBMAN, Howard M. – *Chapter 11: Base*… p. 10; PISTONE, Pasquale – *Chapter 1: General*… p. 10.
[706] OECD – *Developing a Multilateral*… p. 9; KLEIST, David – *A Multilateral Instrument for Implementing Changes to Double Tax Treaties: Problems and Prospects*. Intertax. Volume 44, issue 11 (2016) p. 824.
[707] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 241; KAROLYI, Balazs – *The Challenges of*… pp. 50-51; PROXENOS, Jolani – *An analysis of*… p. 43; OECD – *Developing a Multilateral*… p. 9; BRAVO, Nathalie – *Chapter 1: Tax*… p. 18.
[708] KAROLYI, Balazs – *The Challenges of*… pp. 50-51; KLEIST, David – *A Multilateral Instrument*… p. 824.
[709] KAROLYI, Balazs – *The Challenges of*… pp. 51, 53-54; PROXENOS, Jolani – *An analysis of*… p. 43; KLEIST, David – *A Multilateral Instrument*… p. 824; OECD – *Developing a Multilateral*… p. 9.
[710] OECD – *Addressing Base Erosion*… pp. 51, 53; OECD – *Action Plan on*… p. 24.

coordinated fashion, with the success of the overall strategy against BEPS practices residing on the feasibility, and success, of such vessel[711].

Action 15 was devised to assess the legal and practical feasibility of a multilateral instrument capable of implementing the treaty-related recommendations from the BEPS Project's relevant Actions in a swift, coordinated and harmonious manner through the amendment of the DTT global network, absent the burdensome need to negotiate and go through each DTT's domestic implementation process[712].

This instrument should allow the automatic modification of the application of the DTTs of its signatories as per the relevant Actions, thus ensuring a prompt and coordinated implementation of the BEPS Project's treaty-related recommendations across the DTT global network[713]. Particularly relevant for the minimum standard recommendations.

The development of a multilateral instrument that could match the BEPS Project's requirements to implement its recommendations across the DTT global network raised several concerns in the tax and public international law fields, all of which had to be properly addressed to conclude on the feasibility and practicality of such an instrument[714].

On this matter, it is important to note that similar multilateral treaties exist in other fields of international law, therefore this solution would be legally viable[715].

Despite the existence of other multilateral treaties in taxation, and that a similar proposal had already been presented under the OECD's aegis, this project was still quite unique in the existing international framework, both considering the support and momentum it had built, and the envisaged magnitude of its reach and effects[716].

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711 OECD – *Developing a Multilateral*… p. 9.
712 *Ibid*; PROXENOS, Jolani – *An analysis of*… pp. 43-44; LIEBMAN, Howard M. – *Chapter 11: Base*… p. 10; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 240; BRAUNER, Yariv – *Treaties in the*… pp. 1019, 1030; KLEIST, David – *A Multilateral Instrument*… p. 824.
713 KAROLYI, Balazs – *The Challenges of*… p. 53; OECD – *Developing a Multilateral*… p. 9; OECD – *Explanatory Statement To*… p. 3; GONZÁLEZ-BARREDA, Pablo A. Hernández – *A Historical Analysis*… p. 291; LIEBMAN, Howard M. – *Chapter 11: Base*… p. 10.
714 OECD – *Developing a Multilateral*… pp. 9-10.
715 KAROLYI, Balazs – *The Challenges of*… p. 52; OECD – *Developing a Multilateral*… pp. 20-23.
716 OECD – *Developing a Multilateral*… p. 9; KAROLYI, Balazs – *The Challenges of*… pp. 51-53; BRAVO, Nathalie – *Chapter 1: Tax*… pp. 8-11, 16-17.

As it could be expected, Action 15 concluded that the development and adoption of a multilateral treaty to streamline the implementation of treaty-related measures arising from the other Actions was both desirable and feasible, therefore, countries should develop this multilateral instrument with haste, to not lose neither the political support and momentum gathered nor the opportunity to effectively combat and prevent BEPS practices, relying upon its 2014 report, preferably before MNEs had time to adjust[717].

This multilateral treaty would incorporate the other Actions' recommendations and automatically affect the DTTs of its signatories, following its own domestic implementation process (generally, ratification), thus bringing those DTTs in compliance with the BEPS Project's standard with a flexible targeted approach while respecting countries' sovereignty[718].

Also, this solution may provide an interesting platform for future consensual modifications to DTTs, paving the way for multilateralism in international taxation[719].

Action 15 went further on the multilateral instrument's development, which had to be conducted rapidly. Its final report, following the OECD/G20's endorsement, issued a mandate for the creation of a vast group of countries to develop the MLI, *i.e.* the *ad hoc* Group, open to all countries (including non-OECD countries) and that resides on equal footing participation without being bound to adhere to its deliverables[720].

The *ad hoc* Group, which is not a body of the OECD and comprises over 100 stakeholders from all quadrants of the international taxation system, successfully embraced the task of negotiating and developing the MLI's final deliverable[721] and

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[717] OECD – *Developing a Multilateral*… pp. 10, 15-23; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 240; BRAUNER, Yariv – *Treaties in the*… p. 1019.
[718] OECD – *Developing a Multilateral*… pp. 15-23; LIEBMAN, Howard M. – *Chapter 11: Base*… p. 10; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 557; BRAUNER, Yariv – *Treaties in the*… pp. 1019; KAROLYI, Balazs – *The Challenges of*… pp. 53, 56.
[719] BRAUNER, Yariv – *McBEPS: The MLI*… p. 7; BRAUNER, Yariv – *Treaties in the*… pp. 1030-1031; BRAVO, Nathalie – *Chapter 1: Tax*… p. 20; KLEIST, David – *A Multilateral Instrument*… p. 830.
[720] OECD – *Developing a Multilateral*… pp. 10-12; KAROLYI, Balazs – *The Challenges of*… p. 53; OECD – *Explanatory Statement To*… pp.1-2.
[721] OECD – *Multilateral Convention To Implement Tax Treaty Related Measures To Prevent Base Erosion And Profit Shifting*. OECD. 2016. Available at: https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf

the Explanatory Statement[722], culminating with the OECD/G20's adoption of both deliverables on November 24th, 2016[723].

An initial MLI signing ceremony took place on June 7th, 2017, with 68 countries present (including Portugal), which started its implementation process, as it would enter into force upon the fifth signatory's domestic implementation process had been completed and notified, hence on July 1st, 2018, following Slovenia's ratification and deposit, the MLI entered into force, marking a turning point for the international taxation system[724].

The MLI's early stages have been presented herein, from its initial thought to its unveiling and entering into force as a fully-fledged multilateral tax treaty, combing through its origin and purpose as a decisive element for the BEPS Project.

With this note, it matters to address some of the MLI's core aspects that are relevant to assess its role in the PE concept.

3.1.2. Key elements and features

The MLI's entry into force is a high point in a painstaking ride to achieve some palpable level of multilateralism in taxation. Although there were other analogous experiences, the MLI's scale and support together with the exact field it exerts its influence, DTTs, makes it unequivocal[725].

Therefore, it is pertinent to dissect the MLI and understand its functioning and content, together with its structure and standing point vis-à-vis existing DTTs. Furthermore, the relationship between the MLI and its signatories could provide some valuable insights to comprehend its possible impact on the PE concept.

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[722] OECD – *Explanatory Statement To*…

[723] OECD – *Developing a Multilateral*… pp. 10-12; KAROLYI, Balazs – *The Challenges of*… p. 53; OECD – *Explanatory Statement To*… pp. 1-2; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… pp. 15-16.

[724] OECD – *Signatories and Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*. OECD. December 21st, 2020. Available at: https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf

[725] BRAVO, Nathalie – *Chapter 1: Tax*…p. 20; BLUM, Daniel W. – *The Relationship between the OECD Multilateral Instrument and Covered Tax Agreements: Multilateralism and the Interpretation of the MLI*. Bulletin for International Taxation. Volume 72, number 3 (2018) p. 131.

3.1.2.1. Structure and nature

As a starting point, the MLI is a 39 articles-long open multilateral convention, split into seven parts, adopted in English and French, as authentic languages, by a vast ensemble of countries – the OECD has translated it into other non-authentic languages, meaning that for interpretational matters it is necessary to resort to either the English or French version[726].

The purpose of the MLI is to swiftly implement the BEPS Project's treaty-related recommendations, which should, generally, occur without material modifications to these[727]. This implementation shall happen by modifying the application of the relevant provisions on the DTTs (bilateral or multilateral) that were elected for this purpose[728]. The MLI's operative method already hints at the relationship between the MLI and existing DTTs.

Considering that the MLI will only target DTTs, its reach is restricted to the implementation of Actions 2, 6, 7 and 14's proposals, which have been enshrined in it for swift implementation across the DTT network, with particularities amongst them[729]. Of those, only two have been considered minimum standards (Actions 6 and 14)[730].

With the MLI's structural features revealed, we will address its nature, where, although it is a multilateral convention with multiple parties and open for all those

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[726] OECD – *Multilateral Convention To…*; GOMES, Marcus Livio – *The OECD Multilateral*… p. 240; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… pp. 28-29; DOURADO, Ana Paula – *Governação Fiscal Global*… p. 90; LANG, Michael [et. al.] – *The OECD Multilateral Instrument for Tax Treaties: Analysis and Effects: Analysis and Effects*. Wolters Kluwer. 2018 p. 80.

[727] OECD – *Explanatory Statement To*… p. 2; GARBARINO, Carlo – *Permanent Establishments and*… p. 365; DOURADO, Ana Paula – *Governação Fiscal Global*… p. 88; OECD – *Opinion of the Conference of the Parties of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*. OECD. May 20th, 2021. p. 2. Available at: https://www.oecd.org/tax/treaties/beps-mli-cop-opinion-interpretation-and-implementation-questions.pdf

[728] OECD – *Explanatory Statement To*… p. 3; LANG, Michael [et. al.] – *The OECD Multilateral*… pp. 3-4, 6-9; OECD – *Opinion of the*… pp. 2-4.

[729] OECD – *Explanatory Statement To*… p. 2.

[730] OECD – *Explanatory Statement To*… p. 3.

that wish to adhere to it, its effects still occur at a bilateral level and, at its heart, the MLI still embraces bilateral relations between countries[731].

By analysing its functioning, it is arguable that beneath the robes of a multilateral convention, the MLI might be an amplified bilateral agreement, one that serves as a platform for simplified discussion and modifications between two countries[732].

This almost travesty nature of the MLI results from the need to reach a broad agreement in the negotiations for its development, where it was fundamental to safeguard two principles, countries' tax sovereignty and bilateral relations, to achieve the countries' amplest possible acceptance and support to the MLI[733]. These two principles have always been at the discussions' centre regarding multilateral treaties in taxation, which have almost always ended with the proposals' dismissal[734].

Therefore, for a multilateral instrument to become feasible it was necessary to accommodate those two principles in the best possible way so that the largest possible number of countries could agree and accept it, including developed and developing countries that share different views regarding taxation[735]. The *ad hoc* Group took note and addressed these concerns in the MLI through several provisions, leading to the MLI's bipolar nature.

For instance, the MLI's application hinges on the signatories' notifications by reference to each DTT and each of its provisions, which resides on an optional prerogative for each country to include a specific DTT, and its provisions, or not[736].

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[731] By reference to the intricacies of the MLI's nature, we highlight the remarkable and detailed work by Yariv Brauner in *McBEPS: The MLI – The First Multilateral Tax Treaty that Has Never Been*. Intertax. Volume 46, issue 1 (2018) pp. 6-17.

[732] BRAUNER, Yariv – *McBEPS: The MLI*… pp. 6-8; BLUM, Daniel W. – *The Relationship between*… p. 135; HASLEHNER, Werner C. – *A Multilateral Interpretation of the Multilateral Instrument (and Covered Tax Agreements)?*. Bulletin for International Taxation. Volume 74, number 4/5 (2020) p. 222.

[733] OECD – *Developing a Multilateral*… pp. 16-23; KAROLYI, Balazs – *The Challenges of*… pp. 53-54; BRAVO, Nathalie – *Chapter 1: Tax*…p. 19; BRAUNER, Yariv – *Treaties in the*… pp. 1019-1020; KLEIST, David – *A Multilateral Instrument*… p. 828; BLUM, Daniel W. – *The Relationship between*… p. 135.

[734] BRAVO, Nathalie – *Chapter 1: Tax*… pp. 18-19, 21; KAROLYI, Balazs – *The Challenges of*… pp. 53-54; BRAUNER, Yariv – *Treaties in the*… p. 1019; KLEIST, David – *A Multilateral Instrument*… p. 828.

[735] BRAVO, Nathalie – *Chapter 1: Tax*… p. 21; PISTONE, Pasquale – *Chapter 1: General*… p. 11; HATTINGH, Johann – *The Impact of the BEPS Multilateral Instrument on International Tax Policies*. Bulletin for International Taxation. Volume 72, number 4/5 (2018) pp. 235-236.

[736] KAROLYI, Balazs – *The Challenges of*… pp. 53-54; BRAVO, Nathalie – *Chapter 1: Tax*… p. 19; OECD – *Opinion of the*… p. 7; BROKELIND, Cécile – *Chapter 8: The Multilateral Instrument and Asymmetric*

Another consequence of those concerns is the MLI's significant flexibility, almost modular, where a multitude of options over its provisions are offered to countries, thus preserving their tax sovereignty and the possibility to adjust the MLI's effects to each country's bilateral relations[737].

Due to the countries' aversion to adopting an absolute multilateral tax treaty, the MLI's flexible application and somewhat bipolar nature was undoubtedly the necessary cost to bear to have a vessel that could achieve swift and synchronized implementation of the BEPS Project's measures over a significant portion of the DTT global network[738].

This cost might be too heavy to bear, given that the concessions made could negatively affect the MLI, as it created an overly complex system that requires careful navigation from parties interested in adhering to it[739]. Also, due to the substantial flexibility, its consistency and effective application to the DTT network could be significantly diminished, with reduced notifications and eligible DTTs, together with divergent country practices, a cause of BEPS practices[740].

Moreover, the MLI mostly stands as a single-event instrument to modify the DTT network and bring it to compliance with the BEPS Project's measures. The MLI goes even further in article 37 by instituting that even where a party withdraws from it, its CTAs shall continue to be applied as modified by the MLI, however, this reinforced position favourable to multilateralism is then collapsed by article 30, by

Choices under Articles 12-15 on PE Threshold In DOURADO, Ana Paula ed. – *International and EU Tax Multilateralism: Challenges Raised by the MLI*. Books IBFD. 2020. p. 5.

[737] KAROLYI, Balazs – *The Challenges of*… pp. 55-56; BRAVO, Nathalie – *Chapter 1: Tax*…p. 19; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 558; BRAUNER, Yariv – *Treaties in the*… p. 1019; KLEIST, David – *A Multilateral Instrument*… p. 828; PISTONE, Pasquale – *Chapter 1: General*… p. 9; BRAUNER, Yariv – *McBEPS: The MLI*… pp. 7-8, 12; BLUM, Daniel W. – *The Relationship between*… p. 135; OECD – *Opinion of the*… p. 5; SMITH, ANDREW M. C. – *The New China-New Zealand Income Tax Treaty (2019) – How Does It Shape Up Following The BEPS Project And The MLI?*. Bulletin for International Taxation. Volume 74, number 7 (2020) p. 441.

[738] BRAVO, Nathalie – *Chapter 1: Tax*…pp. 2, 18-21; KAROLYI, Balazs – *The Challenges of*… p. 56; BRAUNER, Yariv – *Treaties in the*… p. 1019; KLEIST, David – *A Multilateral Instrument*… p. 828; BRAUNER, Yariv – *McBEPS: The MLI*… pp. 12, 16-17; BLUM, Daniel W. – *The Relationship between*… p. 135.

[739] BRAUNER, Yariv – *McBEPS: The MLI*… pp. 9-11; DOURADO, Ana Paula – *Are We Compatible?: On Multilateral Tax Coordination*. Intertax. Volume 46, issue 1 (2018) pp. 3-4.

[740] KAROLYI, Balazs – *The Challenges of*… pp. 56-57; GONZÁLEZ-BARREDA, Pablo A. Hernández – *A Historical Analysis*… p. 292; PISTONE, Pasquale – *Chapter 1: General*… p. 9; BRAUNER, Yariv – *McBEPS: The MLI*… p. 9; KLEIST, David – *A Multilateral Instrument*… p. 830.

confirming that parties may subsequently renegotiate CTAs and expunge the MLI's influence and modifications, which is a blunt expression of bilateralism.

Nonetheless, this compromise does not impair the MLI's inherent multilateral characteristics and that it should still be revered as a milestone for international taxation in what is hoped to be a first step of a successful path.

Lastly, the implementation process of the MLI itself comes as a great advantage vis-à-vis the renegotiation of the DTT network.

Similar to other international treaties, the MLI should follow and comply with domestic implementation processes, however, considering its operative design for modifying the DTTs' application, once the MLI's domestic process is complete and it enters into force and effect, no additional domestic processes are needed, as the DTTs' modification emanates from the substantive provisions of a single legal instrument that already complied with such process, thus streamlining the modifications of the DTTs application[741].

3.1.2.2. Flexibility, CTAs and notifications

Flexibility is a fact in the MLI's substantive provisions, although limited for minimum standards' provisions, for the other provisions, the MLI provides countries with plenty of latitude[742].

This feature is particularly relevant due to the level of flexibility present in the Action 7-related provisions, since Action 7 is not a minimum standard, countries may opt not to apply the MLI's provisions related with the PE concept[743].

Within the MLI, countries are bound to commit to the application of a minimum group of provisions to their DTTs, and, at the same time, we find three noteworthy shreds of evidence of flexibility vis-à-vis the MLI's substantive rules that are not a

[741] KLEIST, David – *A Multilateral Instrument*… p. 825; BRAVO, Nathalie – *Chapter 1: Tax*… p. 19.
[742] On this matter, we follow and call attention to Nathalie Bravo's remarkable work in *A Multilateral Instrument for Updating the Tax Treaty Network*, especially in its chapter 4.
[743] DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 558; OECD – *Explanatory Statement To*… pp. 3-4.

part of that group: reservations (opt-out), opt-in clauses, and alternative measures[744].

Before addressing the MLI's flexibility devices, it must first be established to which DTTs the MLI applies, as this is also a form of flexibility provided to countries[745].

In this sense, the MLI only applies to DTTs that are in force between at least two of the MLI signatories and that both have expressed their intention for it to be covered by the MLI's provisions, thus a DTT becomes a Covered Tax Agreement[746][747]. For this purpose, signatories must make similar notifications upon the deposit of their domestic instrument for the MLI's implementation[748].

In other words, countries are not obliged to submit DTTs to the MLI and the MLI only applies to CTAs, meaning that only DTTs that both countries agree to submit to the MLI will be automatically modified[749]. Therefore, for a DTT to become a CTA two conditions must be fulfilled, firstly the DTT must be in force between both signatories, and secondly, both signatories must submit it to the MLI. Once again, flexibility is present so countries still retain their sovereignty to revise DTTs through bilateral negotiations outside the MLI.

With the MLI's target cleared, we advance onto the flexibility tools and their role vis-à-vis the CTAs. First, opt-in clauses allow countries to vary their commitment level to the MLI, meaning that countries may opt to apply additional MLI provisions to their CTAs, other than those that would automatically apply[750].

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[744] OECD – *Explanatory Statement To*… pp. 3-4; BRAVO, Nathalie – *Chapter 1: Tax*… p. 19; KAROLYI, Balazs – *The Challenges of*… p. 56; BRAUNER, Yariv – *McBEPS: The MLI*… p. 8; HATTINGH, Johann – *The Multilateral Instrument from a Legal Perspective: What May Be the Challenges?*. Bulletin for International Taxation. Volume 71, number 3/4 (2017). p. 4; LANG, Michael [et. al.] – *The OECD Multilateral*… pp. 140-141; OECD – *Opinion of the*… p. 5.

[745] HATTINGH, Johann – *The Multilateral Instrument*… p. 4; LANG, Michael [et. al.] – *The OECD Multilateral*… p. 4.

[746] Herein, a DTT should be understood as also including amending protocols or accompanying instruments thereto, as they will all fall under the MLI's scope.

[747] OECD – *Multilateral Convention To…* p. 2; OECD – *Explanatory Statement To*… pp. 3, 9-10.

[748] OECD – *Multilateral Convention To…* p. 1; OECD – *Explanatory Statement To*… pp. 3, 9.

[749] OECD – *Explanatory Statement To*… pp. 3, 9; KLEIST, David – *The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS–Some Thoughts on Complexity and Uncertainty*. Nordic Tax Journal. Volume 2018, issue 1 (2018) p. 34; BRAUNER, Yariv – *McBEPS: The MLI*… p. 8; HATTINGH, Johann – *The Multilateral Instrument*… p. 4; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… p. 22.

[750] KAROLYI, Balazs – *The Challenges of*… p. 56; KLEIST, David – *The Multilateral Convention*… pp. 34-35; BRAVO, Nathalie – *Chapter 4: Flexibility in the Multilateral Instrument* In *A Multilateral Instrument*

Second, alternative measures replicate the treaty-related Actions' reports' proposals that foresaw different paths to achieve their intended goal, hence countries may select the alternative they deem fit to apply to a CTA, however, for it to apply to a CTA both parties have to select the same alternative[751].

Finally, MLI's reservations (opt-out) clauses follow the general rule of international treaties, which broadly mean that a country may reserve its right not to apply a certain provision of the MLI (or part thereof) to its DTT network (not to a single, or a selection of, CTAs), thus that country's DTTs, CTAs or not, shall remain unaffected by the MLI on the reserved matter[752]. However, article 28 MLI foresees a closed list of allowed reservations, limiting a country's options[753].

These three types of clauses have nuances when referring to minimum standard and non-minimum standard provisions, for instance, situations where a party to the MLI may opt-out of a minimum standard provision are very limited, such as where the relevant CTA is already compliant[754]. Conversely, a party to the MLI may freely opt to not apply the MLI's provisions applicable to the PE concept entirely, *i.e.*, part IV[755].

Also, articles 28 and 29 MLI clarify that the options taken by MLI signatories under the flexibility mechanisms at the time of deposit of their instrument of ratification are not permanent, meaning that they have a dynamic nature and the MLI parties may modify their opt-ins, alternative measures and reservations, notably to augment their MLI commitment[756].

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for Updating the Tax Treaty Network. Books IBFD. 2020. pp. 3, 5, 34; LANG, Michael [et. al.] – *The OECD Multilateral*… pp. 142-143.

[751] KAROLYI, Balazs – *The Challenges of*… p. 56; OECD – *Explanatory Statement To*… p. 4; KLEIST, David – *The Multilateral Convention*… p. 35; BRAVO, Nathalie – *Chapter 4: Flexibility*… pp. 10-13; LANG, Michael [et. al.] – *The OECD Multilateral*… pp. 144-145.

[752] KAROLYI, Balazs – *The Challenges of*… p. 56; OECD – *Explanatory Statement To*… pp. 3-4; KLEIST, David – *The Multilateral Convention*… p. 35. BRAUNER, Yariv – *McBEPS: The MLI*… pp. 11-12 BRAVO, Nathalie – *Chapter 4: Flexibility*… pp. 19-20; LANG, Michael [et. al.] – *The OECD Multilateral*… pp. 140-142.

[753] BRAUNER, Yariv – *McBEPS: The MLI*… pp. 11-12; BRAVO, Nathalie – *Chapter 4: Flexibility*… pp. 20-24, 35; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… p. 23; LANG, Michael [et. al.] – *The OECD Multilateral*… pp. 142, 157.

[754] OECD – *Explanatory Statement To*… p. 3; KLEIST, David – *The Multilateral Convention*… pp. 34-35; BRAVO, Nathalie – *Chapter 4: Flexibility*… p. 35; GOMES, Marcus Livio – *The OECD Multilateral Instrument for Tax Treaties: Analysis and Effects, M. Lang, P. Pistone, A. Rust, J. Schuch and C. Staringer (editors), Wolter Kluwer, 2018*. Intertax. Volume 47, issue 2 (2019) p. 241.

[755] KAROLYI, Balazs – *The Challenges of*… p. 56; KLEIST, David – *The Multilateral Convention*… p. 42.

[756] KLEIST, David – *The Multilateral Convention*… pp. 35-36; BRAUNER, Yariv – *McBEPS: The MLI*… pp. 11-12.

Following our remarks on both the MLI's flexibility mechanisms and on the definition of CTA, it matters to address how MLI signatories can convey the DTTs they are willing to submit to modification by the MLI and the options they have taken vis-à-vis the MLI's substantive rules.

This occurs via a mandatory notification process to the MLI's Depositary (*i.e.*, the OECD's Secretary-General), through which a signatory elaborates a list of the DTTs it wishes to see modified by the MLI and identifies the positions it has taken concerning each individual provision of the MLI, to bare its stance on the MLI and set boundaries to its MLI commitment[757].

Such a mandatory process is vital to the MLI, as it triggers the MLI's potential application to a signatory's DTT network, contingent on the actions taken by its counterparts[758]. It is from the combined interconnection of all notifications, which will generate "matches" between DTTs and positions, that the wheels of the MLI start turning.

The notification process's combined interconnection also raises issues within the MLI, on the one side the effective "matching" that will occur, and on the other its asymmetrical application due to its flexibility[759].

As mentioned, for the MLI to apply to a DTT, the latter first needs to become a CTA, *i.e.* the relevant signatories' notification must "match" on the intention to submit it to the MLI, afterwards, for the MLI to modify that CTA's application, those signatories' notification should also "match" on the positions taken vis-à-vis the relevant provisions[760]. We highlight that for the MLI to apply to a CTA, the relevant signatories' notification is not required to be a complete "match" regarding all provisions, it may only "match" on one, as this step is assessed per provision.

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[757] OECD – *Explanatory Statement To*… p. 5; KLEIST, David – *The Multilateral Convention*… p. 35; HATTINGH, Johann – *The Multilateral Instrument*… p. 4; BRAVO, Nathalie – *Chapter 3: The Relationship between the Provisions of the Multilateral Instrument and the Provisions of the Covered Tax Agreements* In *A Multilateral Instrument for Updating the Tax Treaty Network*. Books IBFD. 2020. p. 19; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… p. 24.; LANG, Michael [et. al.] – *The OECD Multilateral*… pp. 157-158, 198-200; OECD – *Opinion of the*… pp. 5, 7.

[758] KLEIST, David – *The Multilateral Convention*… p. 34; OECD – *Opinion of the*… p. 7.

[759] DOURADO, Ana Paula – *Are We Compatible?*… p. 3; BRAVO, Nathalie – *Chapter 4: Flexibility*… pp. 31-34; HATTINGH, Johann – *The Multilateral Instrument*… p. 5; GOMES, Marcus Livio – *The OECD Multilateral* Instrument… p. 241; HATTINGH, Johann – *The Impact of*… p. 236.

[760] MALHERBE, Jacques – *A New Tax*… p. 48.

To put it in an illustrative example, for the MLI to modify the PE's provisions of Country A and Country B's DTT, both countries must include it in their respective notification and take the same positioning on part IV of the MLI. Where Country B reserved its right to not apply part IV of the MLI to its CTAs and Country A opted to apply it, the PE provisions will not be modified by the MLI, since there was no "match".

On this topic, considering the operative similarities and for easier reference, we evoke the common nickname given to this analysis of the MLI's notifications: the "tinder approach". Where there is a "match" the MLI applies, be it for a CTA, a specific alternative, or a reservation[761].

In this context, practice, with some support among scholars, has demonstrated that countries are interpreting the notification process as the constitutive element of their obligations under the MLI and of their DTT network's modification, reason why some countries have revealed caution in this process and halted their signature/ratification or adopted a conservative approach at the moment of confirmation of their commitment towards the MLI[762]. Although worrisome, its relevance moderates when considering the dynamic nature of the parties' commitment to the MLI (with increasing countries expanding their commitment through subsequent notifications adding DTTs[763]).

There are advantages in not adhering to the MLI soon, in waiting to see the positions other countries take since afterwards the late joiners will be in an advantageous position vis-à-vis early-birds and could adjust their commitment to the MLI to better fit their interests, as opposed to being surprised by other countries' positions, reserving on all possible matters, or not listing all its DTTs[764].

With effect, the notification each signatory makes embodies the set of rights and obligations it assumes under the MLI before all other parties to it, although these may not be definitive, as a party's commitment may be bolstered[765].

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[761] HATTINGH, Johann – *The Multilateral Instrument*… pp. 4-5.
[762] BRAUNER, Yariv – *McBEPS: The MLI*… pp. 9-11, 13; DOURADO, Ana Paula – *Are We Compatible?*… p. 3; LANG, Michael [et. al.] – *The OECD Multilateral*… pp. 194-195; OECD – *Opinion of the*… p. 5.
[763] OECD – *Signatories and Parties*…
[764] BRAUNER, Yariv – *McBEPS: The MLI*… pp. 9-11, 13; HATTINGH, Johann – *The Impact of*… pp. 236-237; SMITH, ANDREW M. C. – *The New China*… p. 446.
[765] BRAVO, Nathalie – *Chapter 4: Flexibility*… pp. 9, 34; LANG, Michael [et. al.] – *The OECD Multilateral*… pp. 159-164; OECD – *Opinion of the*… p. 5.

Following the signatories' notification process, the MLI will modify the application of the DTTs that have matched, *i.e.* those DTTs on which both parties notified their willingness to subject them to the MLI in similar terms, including, when applicable, the same options.

The notification process is the MLI's heart, and its success depends on the number of matches that effectively occur, especially regarding the non-minimum standard provisions where the acceptance of the MLI and its provisions can be judged[766].

Considering the above, Action 7's implementation on DTTs via the MLI might be reduced vis-à-vis the expectations built around the latter, since the MLI parties must agree to submit their DTTs to it and must choose to apply its PE measures, and, for the preparatory or auxiliary provisions, in the same fashion[767].

Furthermore, the MLI might still end up being a tainted gift from the BEPS Project to the international taxation system due to its complex and flexible functioning fostering the unwanted outcome of a patchy implementation process for the anti-BEPS treaty-related measures, which could cast a shadow over its success on reaching a comprehensive consensus for its development and effectively entering into force as a multilateral tax treaty.

We have concluded the analysis on the MLI's core operative elements, essential to grasp its functioning and to understand how it relates with the existing DTTs.

3.1.2.3. Relation with DTTs

Following the above, we will focus on a brief exposition on the relationship between the MLI and the existing DTTs, the last key element of the MLI essential for the analysis of its provisions implementing Action 7 and their potential impact on the international taxation system through the DTT network.

Article 1 MLI hints at the MLI's relation with DTTs by stating that it modifies CTAs, revealing a careful choice of wording for its scope, as the MLI does not replace

[766] PISTONE, Pasquale – *Chapter 1: General*… p. 9; BRAUNER, Yariv – *McBEPS: The MLI*… p. 8; KAROLYI, Balazs – *The Challenges of*… p. 62.
[767] KAROLYI, Balazs – *The Challenges of*… pp. 56-57.

CTAs, instead, it operates alongside CTAs, modifying the application of, and/or replacing, their provisions[768].

The MLI provisions will either modify the application of an existing CTA provision, to comply with the relevant MLI provision; or, where the CTA does not possess a provision, the MLI supersedes the CTA and the MLI provision applies directly to and through the CTA on the relevant situation[769].

The MLI's relationship with DTTs is not similar to that of a newer treaty nor of an amending protocol, the MLI is itself an international convention and it stands side-by-side with the CTAs, modifying their application, so the publication of condensed versions of CTAs will not be required, although they could become helpful for interpreters[770].

In fact, it will always be required to jointly analyse the CTA and the relevant MLI portions that modify it when applying that CTA, although there are two legal instruments, there is only one joint stream of obligations for the relevant countries[771]. There is an almost umbilical/matrimonial bond between CTAs and the MLI, in which both are self-standing but need each other to execute their task, *i.e.*, apply tax treaty provisions to cross-border situations.

While the MLI and CTAs may harmoniously coexist, there are several areas where their provisions are bound to conflict, hence it becomes necessary to unravel said conflict. In this sense, generally, the *lex posteriori* principle enshrined in article 30 (3) and (4) VCLT applies between the MLI and CTAs' provisions, meaning that the MLI provision will prevail over those of the CTAs, thus modifying it[772].

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[768] KLEIST, David – *The Multilateral Convention*… p. 34; BRAUNER, Yariv – *McBEPS: The MLI*… p. 11; GOMES, Marcus Livio – *The OECD* Multilateral… p. 240; BLUM, Daniel W. – *The Relationship between*… p. 132; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… pp. 18, 21; OECD – *Opinion of the*… p. 4.

[769] BRAUNER, Yariv – *McBEPS: The MLI*… p. 11; OECD – *Opinion of the*… p. 4.

[770] *Ibid*; GOMES, Marcus Livio – *The OECD Multilateral*… p. 240; OECD – *Explanatory Statement To*… p. 3; BLUM, Daniel W. – *The Relationship between*… p. 132; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… pp. 18, 29-30; BRAVO, Nathalie – *Interpreting Tax Treaties*… pp. 235-236.

[771] BLUM, Daniel W. – *The Relationship between*… p. 133.

[772] KAROLYI, Balazs – *The Challenges of*… pp. 54-55; OECD – *Explanatory Statement To*… p. 6; GOMES, Marcus Livio – *The OECD Multilateral*… p. 241; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… pp. 24-25; LANG, Michael [et. al.] – *The OECD Multilateral*… p. 124; OECD – *Opinion of the*… p. 4.

Following on the *lex posteriori* principle, conflicts between the MLI and CTAs' provisions are sorted via special clauses included in each of the MLI's substantive provisions that soothe their relationship while the MLI modifies the CTAs provisions, *i.e.* the compatibility clauses[773]. These clauses grant primacy to the MLI over CTAs and are vital for the consistent and smooth implementation of its anti-BEPS measures across the DTT network, allowing for the harmonious joint application of the MLI and CTAs, like well-coordinated acrobatics[774].

The MLI compatibility clauses were carefully developed by detailing the type and essential features of the provisions the MLI seeks to modify, without limiting to a strict numerical or terminological approach, this fluid leeway provides certainty and reduces eventual application conflicts between the MLI and CTAs[775].

Furthermore, these compatibility clauses are assisted by specific notification clauses (slightly different from the ones aforementioned) that are designed to provide clarity and transparency on the CTAs provisions that a signatory notified to be modified by the MLI, which are vital for when CTAs do not have an English or French version, CTAs follow the UNMC or that do not follow any model, and CTAs that have different numbering and/or wordings[776].

Further to our matrimonial example, the compatibility and notification clauses function as couples therapy for the MLI and CTAs, assuring that the divergences are sorted out and there is a smooth path ahead.

The MLI has four different compatibility clauses, split following the MLI's effect over the CTAs provision considering the signatories' notification: "in place of" (replacing existing provision, if it exists), "applies to" or "modifies" (modifying the application of the existing provision, if it exists), "in the absence of" (MLI provision applies where there is no CTA provision), or "in place of or in the absence of"

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[773] OECD – *Explanatory Statement To*… pp. 5-6; KAROLYI, Balazs – *The Challenges of*… p. 55; BRAVO, Nathalie – *Chapter 3: The*… pp. 9-10; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… p. 25; OECD – *Opinion of the*… p. 6.

[774] KLEIST, David – *The Multilateral Convention*… p. 34; BRAUNER, Yariv – *McBEPS: The MLI*… p. 11; OECD – *Explanatory Statement To*… pp. 5-6; OECD – *Opinion of the*… p. 5.

[775] KAROLYI, Balazs – *The Challenges of*… pp. 55-56; BRAVO, Nathalie – *Chapter 3: The*… p. 10; LANG, Michael [et. al.] – *The OECD Multilateral*… p. 122; OECD – *Opinion of the*… pp. 6-7.

[776] OECD – *Explanatory Statement To*… pp. 5-6; KAROLYI, Balazs – *The Challenges of*… p. 55; GOMES, Marcus Livio – *The OECD Multilateral*… p. 240; LANG, Michael [et. al.] – *The OECD Multilateral*… pp. 120-122; OECD – *Opinion of* the… pp. 6-7.

(applies in all cases, replacing or adding); the latter being the one with the widest scope[777].

These compatibility clauses and the specific notification clauses are inserted within each of the MLI's substantive rules, guiding its parties and interpreters to navigate within the MLI and its relationship with CTAs.

Focusing on this thesis, the MLI's relevant portion resides in its part IV, "*Avoidance of Permanent Establishment Status*", which goes from article 12 to article 15, with article 12 dealing with commissionaire arrangements, article 13 with preparatory or auxiliary activities, article 14 with splitting-up of contracts, and article 14 with the definition of closely related[778].

In part IV, parties have the possibility to reserve the right to not apply this part of the MLI and article 13 foresees an alternative measure, where parties may opt between two provisions or neither. Also, part IV foresees almost all of the compatibility clauses amongst its articles, article 12 and article 13's options apply "in place of", article 13's anti-fragmentation rule and article 15 "apply to", and article 14 "apply in place of or in the absence of"[779].

Following the above, the exact relationship between the MLI and CTAs and how the former affects the latter's provisions stands clear, especially on those related to the PE concept and ought to prevent its artificial avoidance.

A final note for completeness on the Explanatory Statement, adopted at the same time as the MLI to accompany it. The Explanatory Statement's purpose towards the MLI is not similar, nor is it meant to be, to that of the OECDMC Commentary vis-à-vis the OECDMC, meaning that the Explanatory Statement is not a "Commentary" to the MLI, except for part VI (mandatory arbitration)[780].

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[777] OECD – *Explanatory Statement To*… pp. 5-6; BRAVO, Nathalie – *Chapter 3: The*… pp. 12-17; BLUM, Daniel W. – *The Relationship between*… pp. 132-133; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… pp. 25-27; LANG, Michael [et. al.] – *The OECD Multilateral*… pp. 118-121; OECD – *Opinion of the*… p. 6.

[778] DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 558.

[779] *Ibid*.

[780] GOMES, Marcus Livio – *The OECD Multilateral*… p. 240; OECD – *Explanatory Statement To*… p. 2; KLEIST, David – *The Multilateral Convention*… pp. 40-41; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… pp. 33-34; LANG, Michael [et. al.] – *The OECD Multilateral*… pp. 24-25.

The Explanatory Statement should simply qualify as context under the VCLT nomenclature, in the sense that it provides a contemporary interpretative guide to the MLI's functioning vis-à-vis CTAs (and not of its substantive rules, which should follow the respective BEPS Project's reports and their policy objectives) by relaying the negotiators' intention when developing it[781].

At this point it is clear that the MLI's development was not achieved without hiccups, causing it to embrace a hybrid nature with an unnecessarily complex functioning that stands on several movable parts and requires input from signatories to become effective, which could hinder its success and the swift and consistent implementation of the BEPS Project's treaty-related measures.

The matching system developed to be the MLI's heart, the "tinder approach" for DTTs/CTAs, reveals the MLI's fragility as a consistent and coordinated instrument, potentially causing it to fall victim to its own flexibility.

We reckon that the MLI's effect on the PE concept throughout the DTT network might bring more harm than benefits due to its erratic implementation process, causing further discrepancies among country practices.

Nevertheless, the MLI has already become a beacon within the international taxation system for its level of multilateralism in taxation and because of the broad consensus and support it collected, even if at a cost, and for these it should be praised.

Considering the MLI's background, improving it might be an impossible task, but it is possible, and perhaps easier, for the stakeholders involved in it to increase their commitment and intrepidly pursue multilateralism in a next instrument.

Our analysis of the MLI's key elements and features is complete and from this standpoint it is possible to better comprehend the MLI substantive rules on the PE concept, which we will analyse next, addressing and evaluating the choices made vis-à-vis Action 7.

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[781] GOMES, Marcus Livio – *The OECD Multilateral*… p. 240; OECD – *Explanatory Statement To*… p. 2; AUSTRY, Stéphane [et. al.] – *The Proposed OECD Multilateral Instrument Amending Tax Treaties*. Bulletin for International Taxation. Volume 70, number 12 (2016) p. 685; KLEIST, David – *The Multilateral Convention*… pp. 40-41; OECD – *Opinion of the*… pp. 2-3; HASLEHNER, Werner C. – *A Multilateral Interpretation*… p. 228.

3.2. The Multilateral Instrument – The PE provisions

Having completed the overview on the MLI and understood its key elements and features, and how it interacts with CTAs, the focus now lies on the MLI's central elements for this thesis, *i.e.* the provisions that shall amend the CTAs' PE concept as per Action 7, if a match occurs.

Herein, our analysis will build on top of the previous Chapter detailed analysis and be dedicated to reveal and link the MLI provisions on the avoidance of PE status to those of Action 7, analysing whether the MLI is a simple blunt replication of Action 7 or whether Action 7's measures were improved to address the issues we raised, in which case we will critically analyse them.

Without prejudice to the forthcoming analysis, generally, the MLI replicates Action 7's solutions without modifications, however, there are nuances[782]. The structure of the previous Chapters will be replicated herewith, with article 5 OECDMC as the guiding compass.

3.2.1. Article 14 MLI – splitting-up of contracts

The analysis of part IV of the MLI starts with article 14, which harbours the provisions against the first BEPS strategy, *i.e.* the splitting-up of contracts among related enterprises under the project PE so that enterprises would not surpass the time threshold required to trigger a PE, generally 12 months[783].

Before advancing, article 14 (3) MLI allows the parties to the MLI to reserve their right not to apply this article entirely, or not to apply it to provisions on the exploration/exploitation of natural resources.

Furthermore, article 14 (2) MLI establishes that, where a party has not reserved this article's application, it will apply in place of or in the absence of a relatable CTA provision, meaning that article 14 (1) MLI will either modify the existing provision or, where no similar provision exists, be added to the CTA.

[782] DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 558.
[783] *Ibid*; OECD – *Explanatory Statement To*… p. 45.

Also, as noted, Action 7's solution was mostly based on amendments to the Commentary on article 5 (3) OECDMC, with the anti-splitting specific anti-abuse provision relegated to the Commentary, leaving its adoption at the countries' discretion[784].

With this background, Action 7's anti-splitting specific anti-abuse provision has been tweaked by WP1 before being enshrined in article 14 (1) MLI, with minor adjustments that may bring clarity[785]:

"*1. For the sole purpose of determining whether the period (or periods) referred to in a provision of a Covered Tax Agreement that stipulates a period (or periods) of time after which specific projects or activities shall constitute a permanent establishment has been exceeded:*

a) where an enterprise of a Contracting Jurisdiction carries on activities in the other Contracting Jurisdiction at a place that constitutes a building site, construction project, installation project or other specific project identified in the relevant provision of the Covered Tax Agreement, or carries on supervisory or consultancy activities in connection with such a place, in the case of a provision of a Covered Tax Agreement that refers to such activities, and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days without exceeding the period or periods referred to in the relevant provision of the Covered Tax Agreement; and

b) where connected activities are carried on in that other Contracting Jurisdiction at (or, where the relevant provision of the Covered Tax Agreement applies to supervisory or consultancy activities, in connection with) the same building site, construction or installation project, or other place identified in the relevant provision of the Covered Tax Agreement during different periods of time, each exceeding 30 days, by one or more enterprises closely related to the first-mentioned enterprise,

these different periods of time shall be added to the aggregate period of time during which the first-mentioned enterprise has carried on activities at that

[784] OECD – *Preventing the Artificial*… pp. 42-44; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 558.
[785] OECD – *Explanatory Statement To*… pp. 45-46.

building site, construction or installation project, or other place identified in the relevant provision of the Covered Tax Agreement."[786]

Upon analysing this wording, OECD's WP1 has successfully improved one of Action 7's best measures. As mentioned, we support the implementation of this provision, as it is an effective mechanism to combat MNEs' exiting splitting-up strategies and a deterrent capable of preventing future strategies.

It is now clearer that under this anti-splitting rule all periods of time on which the relevant enterprise has carried on qualifying activities at a building site/project in the Source Country should be considered, and that for this rule to apply, two conditions must be met vis-à-vis the relevant enterprise: (i) that it has carried on qualifying activities for an aggregate time of over 30 days, and (ii) that that aggregate time does not exceed 12 months[787].

This adjustment brings harmony and equality to the provision, making it more adequate to fulfil its purpose, as now its minimum time limit is the same for both the prime enterprise and for each period of the closely related enterprises, *i.e.* 30 days, as beneath this minimum time limit, the provision shall not apply[788].

On top of this significant modification, other adjustments were required to bring this provision in line with the MLI's terminology and make it as broad as possible to cover additional similar CTA provisions, by including references to the supervisory or consultancy activities as well, present in some CTAs[789].

These formal adjustments also include the general description of the type and essential features of the provision the MLI seeks to modify, instead of relying upon numerical or terminological references, as these also change between CTAs[790].

The adjustments made are mostly cosmetic so they have not dented the underlying anti-splitting rule, as it would be expected, therefore we reinforce our support and praise for the anti-splitting rule of article 14 MLI to prevent the artificial

[786] OECD – *Multilateral Convention To…*
[787] OECD – *Explanatory Statement To*… pp. 45-46; MALHERBE, Jacques – *A New Tax*… p. 38; ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… pp. 29-30; DE WILDE, Maarten Floris – *Lowering the Permanent*… pp. 561-562.
[788] *Ibid*.
[789] OECD – *Explanatory Statement To*… p. 46.
[790] *Ibid*.

avoidance of PE status via the splitting-up of contracts between closely related enterprises.

Following the analysis of article 14 MLI, it stands evident that it is mostly a ready for implementation replication of the anti-splitting specific anti-abuse provision recommended by Action 7[791].

Yet, the adjustment made by WP1 is noteworthy and it upgrades an already sound provision to a better one. Also, we note that our remarks on the advantages of an actual anti-splitting provision in DTTs have been addressed by the MLI, at least partly, due to reservations.

Furthermore, the concern raised regarding the eventual relevance of the *tempus* test from the physical PE concept within the application of the anti-splitting provision appears to have been addressed, precisely by the adjustments of WP1, as it is now clear that there are two time thresholds for this provision to apply. As commented, the relevant enterprise will have to carry out qualifying activities at a building site/project in the Source Country for at least 30 days (aggregated) and for no more than 12 months.

Also, this adjustment to the time periods clarifies that when the anti-splitting rule applies both the prime enterprise and the closely related enterprises will be deemed to have a project PE, thus clarifying its wide reach and effectiveness against these BEPS strategies.

Still, our main concern over this Action 7 solution, its lack of guidance and certainty, has not been addressed by the MLI, instead, it intensified it by putting forward an effective solution without proper guidance[792].

Regardless, on the actual provision, the MLI did build upon Action 7 and improved its solution as called for, being worthy of commendation and support in this regard, reason why we maintain our positive remarks on the anti-splitting provision.

[791] DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 562.
[792] KLEIST, David – *The Multilateral Convention*… p. 39.

The crux now lies in this provision's effective implementation swiftly and homogeneously throughout the DTT network, which, based on our remarks and the MLI's limitations, we seriously doubt[793].

In fact, further uncertainty and divergent country practice will occur due to the flexibility provided to the MLI parties over the application of this provision, on this topic, the MLI has not proven to improve upon Action 7[794].

With this topic, our analysis and evaluation of article 14 MLI vis-à-vis Action 7 is concluded and with some auspicious results.

3.2.2. Article 13 MLI – nature of the preparatory or auxiliary activities' exemption

Pursuing the analysis, our attention is steered towards article 13 MLI and the preparatory or auxiliary activities' exemption. As per Chapter 2, our analysis will be split between the provisions that address the concerns regarding the nature of these exemptions and the one on the anti-fragmentation rule.

We begin with the provisions on the nature of the preparatory or auxiliary activities' exemption foreseen in article 13 (2) and (3) MLI, which resides on a dichotomy, either an automatic qualification for a compartment of activities or all activities need to comply with the preparatory or auxiliary test[795].

As commented, article 13 MLI presents the single example of alternative provisions in part IV, where parties may select from two options to modify their CTAs provision or neither option, keeping their CTAs provision[796].

Like article 14 MLI, article 13 (6) MLI allows parties to reserve their right not to apply this article entirely and to reserve their right not to apply article 13 (2) MLI to CTAs that already exclude the automatic qualification of the activities as preparatory

[793] ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… pp. 30-31; SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 241.
[794] ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… pp. 30-31.
[795] OECD – *Explanatory Statement To*… p. 41; MALHERBE, Jacques – *A New Tax*… pp. 36-37; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 561.
[796] OECD – *Explanatory Statement To*… p. 42; MALHERBE, Jacques – *A New Tax*… pp. 36-37; BROKELIND, Cécile – *Chapter 8: The*… p. 3.

or auxiliary, otherwise, it would be a step backwards on the prevention of artificial avoidance for an already compliant provision.

Where these prerogatives are not exercised, article 13 (5) MLI establishes that the selected option will apply in place of the CTAs qualifying provision, thus amending its application[797].

Action 7 unfortunately harboured a dual structure for its solution on the preparatory or auxiliary activities' exemption's nature, embracing both the position that certain activities automatically qualify due to their nature and the position that all provisions are submitted to the preparatory or auxiliary test[798].

Article 13 (2) and (3) MLI reflects these two alternative solutions from Action 7 without substantive modifications, other than the ones required to conform these provisions to the MLI standard terminology and general description of the essential elements of the relevant CTA provision[799]:

"***Option A***

2. Notwithstanding the provisions of a Covered Tax Agreement that define the term "permanent establishment", the term "permanent establishment" shall be deemed not to include:

a) the activities specifically listed in the Covered Tax Agreement (prior to modification by this Convention) as activities deemed not to constitute a PE, whether or not that exception from PE status is contingent on the activity being of a preparatory or auxiliary character;

b) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity not described in subparagraph a);

c) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) and b),

provided that such activity or, in the case of subparagraph c), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.

Option B

[797] OECD – *Explanatory Statement To*… p. 44.
[798] OECD – *Preventing the Artificial*… p. 28; MALHERBE, Jacques – *A New Tax*… pp. 36-37.
[799] OECD – *Explanatory Statement To*… pp. 42-43.

3. Notwithstanding the provisions of a Covered Tax Agreement that define the term "permanent establishment", the term "permanent establishment" shall be deemed not to include:

a) the activities specifically listed in the Covered Tax Agreement (prior to modification by this Convention) as activities deemed not to constitute a permanent establishment, whether or not that exception from PE status is contingent on the activity being of a preparatory or auxiliary character, except to the extent that the relevant provision of the Covered Tax Agreement provides explicitly that a specific activity shall be deemed not to constitute a permanent establishment provided that the activity is of a preparatory or auxiliary character;

b) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity not described in subparagraph a), provided that this activity is of a preparatory or auxiliary character;

c) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) and b), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character."[800]

Article 13 (2) MLI, *i.e.* Option A, foresees that all activities, regardless of their inherent nature, must comply with the preparatory or auxiliary test, which is our favoured solution as it maintains the preparatory or auxiliary activities' exemption's true nature and purpose and is more suited to the current evolving economy, reason why it could properly address BEPS strategies that exploit the automatic qualification safe-harbour[801].

Conversely, article 13 (3) MLI, *i.e.* Option B, follows the traditional path, where there is a compartment of activities that have an inherent preparatory or auxiliary character and are automatically excluded from being deemed as a PE, regardless of their concrete role and nature[802].

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[800] OECD – *Multilateral Convention To…*

[801] OECD – *Explanatory Statement To*… pp. 42-43.; MALHERBE, Jacques – *A New Tax*… p. 37; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 561; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… p. 47.

[802] OECD – *Explanatory Statement To*… p. 43; MALHERBE, Jacques – *A New Tax*… p. 37; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… p. 47.

Following our Chapter 2 analysis, article 13 (2) and (3) MLI are mere replications of Action 7's solutions, with minor formal adjustments to the MLI. Contrary to article 14 MLI, the need to address the concerns raised or to improve the solution failed to be identified.

For instance, for added certainty and clarity, article 13 (2) MLI should eliminate the illustrative examples of activities that commonly have a preparatory or auxiliary character, or while maintaining said illustrative list, it should update it with current and diverse examples that encompass new business models and the DAPE concept.

Furthermore, we reiterate our critique to this two-pronged structure, it goes against the BEPS Project's purpose, *i.e.* to provide for a united front against BEPS strategies. Having multiple solutions will inevitably lead to divergent country practices and the perpetuation of MNEs' BEPS strategies, resulting in an ineffective measure that may even promote these practices.

On this provision, the MLI failed to address the concerns present in Action 7 and its flexibility intensified the concerns regarding divergent country practices and loopholes to be exploited by MNEs. The MLI's coordinated and harmonious implementation of a solution fit to prevent the exploitation of the specific activity exemptions is impaired due to the alternative measures and possible reservations.

A consensus or common pattern is not expected to occur with the signatories' notifications on article 13 (2) and (3) MLI options, thus it is doubtful that these provisions will improve the international taxation system, being likely that it creates a greater gap between countries and foster an environment on which MNEs can thrive, particularly in relation to developing countries[803].

With the analysis on article 13 (2) and (3) MLI concluded, the future looks dire for article 13 MLI's outcome. A bolder action was expected and required when developing the MLI.

[803] ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… p. 30.

3.2.3. Article 13 MLI – fragmentation of activities and the preparatory or auxiliary activities' exemption

Leaving behind the undesired outcome of article 13 (2) and (3) MLI, our focus shifts towards article 13 (4) MLI and the anti-fragmentation rule, Action 7's second solution against the artificial avoidance of PE status through the preparatory or auxiliary activities' exemption.

Beyond allowing parties to reserve their right not to apply article 13 MLI entirely, article 13 (6) MLI also allows them to reserve their right not to apply article 13 (4) MLI while applying the rest of the article[804].

Regarding article 13 (4) MLI's compatibility clause, it establishes that it applies to the CTAs relevant provisions, meaning that it will modify those CTAs provisions equivalent to article 5 (4) OECDMC to add this rule[805].

As commented, the anti-fragmentation rule is a novelty provision proposed by Action 7 to address the second feature of MNEs' BEPS practices exploiting the specific activity exemptions whereby MNEs would fragment cohesive operative businesses among closely related enterprises, each carrying out complementary functions of such business[806].

At first glance, article 13 (4) MLI appears to replicate Action 7's innovative anti-fragmentation rule, adding only the required adjustments on terminology and cross-referencing for reaching the widest possible spectre of CTAs[807]:

> "*4. A provision of a Covered Tax Agreement (as it may be modified by paragraph 2 or 3) that lists specific activities deemed not to constitute a permanent establishment shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting Jurisdiction and:*

[804] OECD – *Explanatory Statement To*… p. 44.
[805] OECD – *Explanatory Statement To*… p. 45.
[806] OECD – *Preventing the Artificial*… p. 39; OECD – *Explanatory Statement To*… p. 44; MALHERBE, Jacques – *A New Tax*… p. 37; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 561.
[807] OECD – *Explanatory Statement To*… p. 44.

a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of a Covered Tax Agreement defining a permanent establishment; or

b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,

provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation."[808]

Upon closer analysis, this provision has been slightly modified vis-à-vis Action 7's proposal, with the subtle addition of paragraph (a)'s last four words. Nonetheless, such an addition is fundamentally connected with the MLI's concern to encompass the largest possible number of DTT variations with its provisions.

Article 13 (4) MLI correctly reflects Action 7's anti-fragmentation rule as a backstop provision suitable to aggregate complementary activities that form part of a cohesive business operation and that have been split amongst closely related enterprises to exploit the preparatory or auxiliary activities' exemption[809].

Similar to article 13 (2) and (3) MLI, article 13 (4) MLI also replicates Action 7's solution without any decent improvement and without addressing the concerns raised regarding its overwide scope and lack of guidance on the concepts it introduces[810].

Further to Chapter 2, although this innovative anti-fragmentation rule's design as a backstop provision could be suitable to target MNEs' BEPS practices exploiting the specific activity exemptions, the flaws and concerns raised therein remain true and applicable to article 13 (4) MLI, with the aggravated remark that this provision

[808] OECD – *Multilateral Convention To…*
[809] ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… pp. 28-29; MALHERBE, Jacques – *A New Tax*… p. 37; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 561.
[810] KLEIST, David – *The Multilateral Convention*… p. 39.

is to be implemented, translating our concerns on realities that could bring adverse consequences.

Article 13 (4) MLI will supply tax administrations with added capacity and legitimacy to target MNEs fragmenting their activities, by arguing the existence of a PE under the boundaries of the anti-fragmentation rule.

This stance by tax administrations is needed and most welcomed whenever this fragmentation occurs with a tax intent to exploit the specific activity exemptions, but it is prejudicial and undesired when there are sound and valid reasons for MNEs to segregate certain activities absent tax reasons, which may turn this provision into a blind weapon at the tax administrations' hands.

Aggressive action by tax administrations paired with this provision's notorious lack of legal certainty, guidance and limits will lead to a spike of disputes and litigation between tax administrations and taxpayers, which is neither the aim of the MLI nor of the BEPS Project.

However, the concerns over article 13 (4) MLI might become secondary, as parties may reserve their right not to apply this provision, leaving the specific activity exemptions unguarded and open for exploitation by MNEs' BEPS practices in those countries, turning them into a beacon for MNEs due to uncoordinated implementation, thus divergent country practices[811].

Unfortunately, article 13 (4) MLI confirms the poor outcome of article 13 (2) and (3) MLI, resulting in an overall missed chance to improve Action 7's solutions and implement an effective and adequate measure to prevent the artificial avoidance of PE status via the specific activity exemptions.

The MLI's praised flexibility is turning into its downfall concerning the rules on preventing the artificial avoidance of PE status.

Our analysis on article 13 MLI is concluded and it revealed some of the MLI's flaws and their effect on the already imperfect solutions from Action 7.

[811] ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… pp. 30-31.

3.2.4. Article 12 MLI – DAPE and commissionaire arrangements

Moving forward, we will address the MLI provisions connected with commissionaire arrangements and similar strategies, beginning with article 12 MLI, specifically, article 12 (1) and (2) MLI, which embody Action 7's solutions against the artificial avoidance of DAPE status through commissionaire arrangements and similar strategies, one of the most discussed topics of Action 7[812].

Following the characteristic of the MLI's part IV, parties are allowed to reserve their right not to apply the entirety of article 12 MLI, a non-minimum standard, meaning that the existing CTAs provisions would remain unaffected[813]. On article 12 MLI's effects over the CTAs provisions, article 12 (3) MLI determines that article 12 (1) and (2) MLI will apply in place of the existing provisions, thus superseding them[814].

Recalling our detailed analysis on commissionaire arrangements and similar strategies, broadly, MNEs deploying these strategies exploit loopholes based on the economic/legal nature of the bond between principal and clients (mostly between Common and Civil Law countries, being more favourable in the latter), and by distorting the independent agent status with closely related persons[815].

Through these arrangements, MNEs have been able to have a significant economic presence in source countries without ever surpassing the PE status' threshold therein[816].

Therefore, Action 7's solutions sought to remove these strategies' incentives and to decrease the PE status' threshold by modifying the relevant provisions so that the exact nature of the bond becomes irrelevant for a PE to exist, shifting the key

[812] OECD – *Explanatory Statement To*… p. 39.
[813] OECD – *Explanatory Statement To*… p. 41.
[814] OECD – *Explanatory Statement To*… pp. 40-41.
[815] OECD – *Preventing the Artificial*… p. 15; KLEIST, David – *The Multilateral Convention*… p. 39; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 559.
[816] OECD – *Preventing the Artificial*… p. 15; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 559.

deeming elements to the agent's actual activities on behalf of the principal and the object of the negotiated contracts.[817]

Also, it sought to remove the abuse-prone reference to brokers and general commission agents as examples of independent status, thus eliminating that sanctuary, and to introduce a presumption against almost exclusive work on behalf of closely related persons, where these agents cannot be deemed to have an independent status[818].

In this context, article 12 (1) and (2) MLI stands as a true copy of Action 7's solutions, despite the adjustments to the MLI terminology and general description of provisions for cross-referencing among CTAs[819]:

"*1. Notwithstanding the provisions of a Covered Tax Agreement that define the term "permanent establishment", but subject to paragraph 2, where a person is acting in a Contracting Jurisdiction to a Covered Tax Agreement on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are:*

a) in the name of the enterprise; or

b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use; or

c) for the provision of services by that enterprise,

that enterprise shall be deemed to have a permanent establishment in that Contracting Jurisdiction in respect of any activities which that person undertakes for the enterprise unless these activities, if they were exercised by the enterprise through a fixed place of business of that enterprise situated in that Contracting Jurisdiction, would not cause that fixed place of business to be deemed to constitute

[817] OECD – *Preventing the Artificial*… pp. 15-27; MALHERBE, Jacques – *A New Tax*… p. 35; KLEIST, David – *The Multilateral Convention*… p. 39; DE WILDE, Maarten Floris – *Lowering the Permanent*… pp. 559-560.

[818] OECD – *Preventing the Artificial*… pp. 15-27; MALHERBE, Jacques – *A New Tax*… p. 36; KLEIST, David – *The Multilateral Convention*… p. 39; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 560.

[819] OECD – *Explanatory Statement To*… pp. 39-40.

a permanent establishment under the definition of permanent establishment included in the Covered Tax Agreement (as it may be modified by this Convention).

2. Paragraph 1 shall not apply where the person acting in a Contracting Jurisdiction to a Covered Tax Agreement on behalf of an enterprise of the other Contracting Jurisdiction carries on business in the first-mentioned Contracting Jurisdiction as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise."[820]

Despite the criticism, the MLI still does not improve Action 7's solutions, be it the substantial modification to the DAPE definition, with the introduction of an innovative approach to the agent's activities vis-à-vis its principal, or the double modification to the independent agent status, with the examples' removal and the addition of the novel dependence presumption[821].

Article 12 and article 13 MLI stand aligned, as both provisions were blindly placed for implementation without further consideration or analysis over the concerns raised regarding the underlying solutions, especially on article 12 MLI whose criticism and need for enhancement is abundant.

Clearly, should article 12 MLI be effectively implemented, and not side-lined by reservations, the PE status' threshold would decrease drastically, yet, as thoroughly denoted, the threshold would be set too low and broad, as there is no consideration for the effective artificial avoidance intent or the sound business reasons for structuring cross-border endeavours, meaning that both sinners and saints would be caught in this net and be deemed to have a PE, even though this was not Action 7's purpose[822].

In a nutshell, article 12 MLI is an overbearing provision that goes beyond its purpose and objective, it is a disproportionate measure that will be profusely

[820] OECD – *Multilateral Convention To…*
[821] OECD – *Explanatory Statement To*… pp. 39-40; DE WILDE, Maarten Floris – *Lowering the Permanent*… pp. 559-560.
[822] KLEIST, David – *The Multilateral Convention*… p. 39; DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 559.

discussed in disputes and litigations between tax administrations and taxpayers. Moreover, criticism is also due on this article's lack of proper guidance on its new concepts and the loose subjectivism it displays[823].

Nonetheless, separately considered, despite the need for clarifications and guidance over its application and interpretation, we support article 12 (2) MLI and the reformulated independent agent status provision with the inclusion of an adequate presumption that rescues its original spirit and purpose (the *bonafide* agent), reaffirming our Chapter 2 comments[824].

As article 12 MLI goes into implementation, we fear that its outcome will be more prejudicial than beneficial to the international taxation system, and, although still detrimental, the reservations to this article might prove to be the lesser evil.

Therefore, we emphasize the remarks made on these measures' need for urgent improvement and the alternatives and suggestions offered, as granting an anti-abuse focus and nature to these measures so that their limits are correctly drawn.

Due to article 12 (1) MLI, tax administrations will see their legitimacy to target cross-border ventures reinforced and they will have the right weapon for aggressive actions, particularly for those where most situations would not qualify as a PE, thus leading to disputes with taxpayers, with the latter bearing a heavy burden to dismiss exacerbated and disproportionate qualifications.

Differently from the above-analysed articles, herein the flaws of the provision itself supplant those inherent to the MLI on flexibility and fostering divergent country practices.

With this note, we have concluded our analysis on article 12 MLI and the DAPE status.

3.2.5. Article 15 MLI – closely related

Moving forward, our analysis focuses on article 15 MLI, which enshrines Action 7's novel provision on the concept of a person closely related to an enterprise, or

[823] KLEIST, David – *The Multilateral Convention*… p. 39.
[824] MALHERBE, Jacques – *A New Tax*… p. 36.

simply closely related. This concept has a transversal role within part IV of the MLI, with most articles alluding to it[825].

Article 15 MLI possesses several particularities vis-à-vis the aforementioned articles, firstly it does not have an equivalent provision in the 2014 OECDMC, nor is it likely to exist one in any pre-BEPS CTA[826]. Moreover, this article is the only one in part IV to limit the parties' reservation prerogative, *i.e.*, parties can only reserve their right not to apply this article if they have also done it by reference to articles 12 (2), 13 (4) and 14 (1) MLI, otherwise article 15 applies[827].

Regarding the compatibility clause, article 15 (1) MLI will apply to CTAs, therefore, it will be added to the existing PE provisions, likely as a new number to the relevant article.

Amongst the articles analysed herein, article 15 MLI stands out as the one where the MLI's terminology and cross-referencing requirements cause the greatest modification to Action 7's solution, yet, it still stands clear that beneath the formal changes, this article is another faithful reproduction of Action 7[828]:

> "*For the purposes of the provisions of a Covered Tax Agreement that are modified by paragraph 2 of Article 12 (Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies), paragraph 4 of Article 13 (Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions), or paragraph 1 of Article 14 (Splitting-up of Contracts), a person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's*

[825] MALHERBE, Jacques – *A New Tax*… p. 38.
[826] As noted, this novel concept and article 7 OECDMC's concept of "associated enterprises", although similar, are not equivalent.
[827] OECD – *Explanatory Statement To*… p. 47.
[828] *Ibid*.

shares or of the beneficial equity interest in the company) in the person and the enterprise."[829]

As commented, we generally agree with this provision, including its subjective element of control based on all facts and circumstances, although it lacks guidance and boundaries, and its objective closely related presumption that sets a suitable threshold for control based on concrete elements.

However, the MLI did not shed the criticisms we had cast over this provision, mostly connected with the lack of proper guidance over its interpretation and application, vital for its correct implementation, and the lack of supporting arguments for developing a novel concept, especially considering article 7 OECDMC's similar concept[830].

On the other hand, as recommended, we applaud the decision to grant this solution an autonomous article/number within the CTAs PE provisions, thus acknowledging its sheer relevance as a cross-sectional provision within the PE concept and bringing further clarity to the MLI.

Furthermore, we highlight article 15 MLI's limitations over the MLI's flexibility, notably on the conditions for parties to exercise their right not to apply it. A proper example of a coordinated and harmonious implementation of Action 7's solutions, something lacking in articles 12, 13 and 14 MLI.

The closely related concept should reveal itself as a pivotal element of the PE concept on the battle against artificial avoidance of PE status, regardless of the underlying strategy.

In conclusion, articles 14 and 15 MLI are a small ray of hope of the MLI's value-added work on Action 7's solutions within a mist of blind copy-paste work. To meet the expectations of such a cutting-edge instrument for the prevention of the artificial avoidance of PE status, action more conscious of the concerns raised and bolder was required.

Having concluded our assessment of the MLI's articles vis-à-vis Action 7's solutions, and, despite needing proper guidance, article 15 MLI is apt for swift and harmonious implementation, unfortunately, the same cannot be said about the

[829] OECD – *Multilateral Convention To…*
[830] KLEIST, David – *The Multilateral Convention*… p. 39.

remaining articles, be it for the flaws on the provisions themselves or due to the lack of assurances of a similar implementation due to the MLI's flexibility[831].

Within the inapt articles, absent of concerns over their effective implementation, articles 14 and 13 (2) MLI would be fit for it, however, effective implementation is the MLI's core and its flexibility has hindered these articles' assessment[832].

3.2.6. Executing Action 7 – outcome

With our assessment of articles 12 to 15 MLI concluded, it matters to analyse the MLI's outcome as Action 7's implementation arm and to conclude whether it has been strictly executing Action 7 or if it has deviated from this path.

The MLI has generally embraced and respected Action 7's solutions within its articles, both their wording and purpose, revealing a faithful execution of its assignment as the implementation vessel of the measures to prevent the artificial avoidance of PE status.

Effectively, the MLI only once deviated from Action 7's final report, and it did so in respect of WP1's supplementary work on Action 7's solution on the splitting-up of contracts, reinforcing the MLI's character as a mere enforcer of approved solutions.

Therefore, we reckon that the MLI has successfully transplanted Action 7's solutions to its midst without distorting them or making unnecessary modifications, revealing itself as a blunt vessel to implement change, that copied solutions with minimal formal adjustments.

As anticipated, the MLI does not bring any relevant update or innovation on Action 7 nor does it affect our Chapter 2 analysis and conclusions, rather these remain accurate and valid, some even strengthened.

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831 ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… pp. 30-31.
832 *Ibid*.

However, Action 7's transplantation is the bare minimum of what the MLI proposes to achieve, *i.e.*, effective, swift, and coordinated implementation across the DTT network, as vast as possible[833].

On the MLI as an innovative legal instrument implementing Action 7 swiftly and homogenously across the DTT network, it still is too early to adequately evaluate its performance, but its flexibility ought to harm its chances of becoming a success[834].

The MLI's compromise for its acceptance and support by the stakeholders based on a (too) flexible construction that grants significant options and reservations to the parties makes us raise several concerns over its ability to effectively carry out Action 7's implementation, especially considering that part IV is not a minimum standard and parties have the right to simply ignore it, despite political commitment[835].

Even if there is some level of implementation of part IV, the possibilities for it to be carried out in a synchronised and consistent fashion, as intended by Action 7, are slim, as we will demonstrate, thus placing the BEPS Project's outcome in jeopardy[836].

Consequently, two assertions can be made on the MLI vis-à-vis Action 7, firstly, it has successfully transplanted the latter's solutions in a consistent sense to secure their implementation across CTAs, however, secondly, its particularities as a flexible, modular, multilateral instrument have seriously damaged the chances of consistent and harmonious implementation, being more likely that it originates various unilateral measures and divergent country practices, *i.e.*, the exact opposite of the BEPS Project's objective and a cause for further BEPS practices and an unbalanced international taxation system[837].

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[833] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 241.
[834] GARBARINO, Carlo – *Permanent Establishments and*… p. 367; KAROLYI, Balazs – *The Challenges of*… p. 62; KLEIST, David – *The Multilateral Convention*… p. 47; DOURADO, Ana Paula – *Are We Compatible?*… p. 4.
[835] DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 558; KAROLYI, Balazs – *The Challenges of*… pp. 57, 62; KLEIST, David – *The Multilateral Convention*… p. 47; ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… p. 31; DOURADO, Ana Paula – *Are We Compatible?*… p. 4; BRAUNER, Yariv – *McBEPS: The MLI*… pp. 16-17.
[836] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 241; KLEIST, David – *The Multilateral Convention*… p. 47.
[837] GONZÁLEZ-BARREDA, Pablo A. Hernández – *A Historical Analysis*… p. 292; BRAUNER, Yariv – *McBEPS: The MLI*… p. 9; BROKELIND, Cécile – *Chapter 8: The*… pp. 5-6.

The MLI's true success might just be the support it received and its formal aspects as an innovative taxation multilateral instrument that could begin a shift towards multilateralism in taxation and its reform.

The MLI requires additional political commitment against BEPS practices from all countries for it to achieve its purpose, countries must shed some of the concerns on multilateralism in taxation and gradually abandon tax competition practices that create and foster BEPS, particularly regarding the artificial avoidance of PE status[838].

Contrary to the BEPS Project's objectives, the MLI has not been the ideal complement to Action 7 and its imperfect solutions, it failed on the swift and coordinated implementation of these solutions and the upgrade of the PE concept.

3.3. The Multilateral Instrument – Reaction to the PE provisions

Following the above background, we can analyse the commitment each country has undertaken under the MLI, or the lack thereof, and assess their reaction to the MLI's part IV, based on a selected countries' acceptance and implementation of the PE-related articles.

Before beginning this analytical work, it matters to present the MLI in broad numbers. Up to July 22nd, 2020, 94 countries signed the MLI and 49 ratified it[839], meaning that almost half of the world's countries signed it and nearly a quarter ratified it, being it a clear example of the support and acceptance around this novel instrument in its first years of existence[840].

Regarding CTAs, the MLI modified over 300 CTAs[841] until July 22nd, 2020, still shy of the OECD's 1680 CTAs milestone, and even more so of the 3500 DTTs currently in existence[842]. This reveals a less impressive standpoint for the MLI regarding its effective implementation since the ratifications are not translating into a proportional number of modified CTAs, likely due to the lack of "tinder matches"

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[838] KAROLYI, Balazs – *The Challenges of*… p. 62; HATTINGH, Johann – *The Impact of*… p. 240.
[839] With 1 one more country signing it and 16 others ratifying it by September 2021.
[840] OECD – *OECD/G20 Inclusive Framework on BEPS Progress report July 2019 – July 2020*. OECD. July 18th, 2020. p. 19. Available at: https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-progress-report-july-2019-july-2020.pdf
[841] As of September 2021, the MLI has modified over 650 CTAs globally and it shall continue to do so.
[842] OECD – *OECD/G20 Inclusive*… p. 19.

between notifications and because countries are not including all DTTs in their final notification.

The Inclusive Framework's data reveals a rather low percentage of modified CTAs per ratification, translating into roughly 6 modified CTAs per party.

Refocusing on the MLI's PE concept, the data available as of July 22nd, 2020, conveys a mix of encouragement and worry, as part IV's acceptance rate among signatories is approximately 50%[843].

With effect, out of 94 signatories, 46 apply article 12 MLI, 55 opted to apply article 13 (2) MLI, 54 apply article 13 (4) MLI, and only 34 apply article 14 MLI[844][845].

This data demonstrates that there is already a significant portion of signatories that have embraced the commitment to amend DTTs to prevent the artificial avoidance of PE status, which is a significant mark for non-minimum standard measures ridden with reservations and options, however, the same data materializes the concerns raised regarding the MLI's proneness to inconsistent implementation, causing divergent country practices[846].

As noted, MNEs will not have an incentive to stop BEPS strategies in countries that reserved their right not to apply one, or all, of the MLI's part IV articles, rather these countries shall become a lure for MNEs seeking to lower their overall tax burden.

A possible silver lining from this data is the hope that the unmodified DTTs are already compliant with Action 7, or in the process of becoming, via bilateral renegotiation, and that, overall, the international taxation system is consistently walking towards the prevention of the artificial avoidance of PE status[847].

Shifting towards a detailed and contemporary analysis, of the G20 countries, only 17 have signed the MLI, being notorious the USA's absence considering its

[843] OECD – *OECD/G20 Inclusive*… p. 20.
[844] In November 2020, Bahrain signed the MLI and, in its initial notification, reserved the right not to apply the MLI's part IV entirely.
[845] OECD – *OECD/G20 Inclusive*… p. 20.
[846] MEHTA, Amar – *Chapter 4: The*… p. 7.
[847] HATTINGH, Johann – *The Impact of*… pp. 236-237, 241; AUSTRY, Stéphane – *Chapter 12: PE*… pp. 490-491; SMITH, ANDREW M. C. – *The New China*… pp. 441-442, 446-447.

presence in the *ad hoc* Group, and of those only 11 have ratified it, revealing once more only a near half acceptance[848].

Within another relevant group for the BEPS Project, a similar outcome emerges, since among the BRICS group[849] four countries have signed the MLI (Brazil has not), and of those only two have ratified it (Russia and India)[850].

Regarding developing countries, the considerable number of countries that have already signed the MLI is auspicious of a higher level of presence of these countries[851].

Continuing with the analysis of selected countries' reaction to the MLI's part IV, we will focus on those that have ratified the MLI and their notifications at that moment, rather than the provisory signing notifications.

In this sense, on the BRICS group, both Russia and India selected option A in article 13 MLI (article 13 (2) MLI). Whilst India did not make any reservation, Russia reserved its right not to apply article 14 MLI with respect to provisions related with the exploration/exploitation of natural resources[852].

On the G20 group, from the 11 countries that ratified the MLI[853], 5 countries reserved their right not to apply article 12 MLI, 3 countries made reservations to article 13 MLI (of these, Australia's and Germany's is only partial) and the UK did not elect any option, 8 countries made reservations to article 14 MLI (Australia's and Russia's is only on the exploration/exploitation of natural resources), and 3 countries reserved their right not to apply article 15 MLI[854].

On article 13 MLI's options, a pattern is becoming visible, as only France opted for option B, meaning that most countries intend to submit all activities to the preparatory or auxiliary test[855].

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848 OECD – *Signatories and Parties*…
849 The group of emerging countries: Brazil, Russia, India, China, and South Africa.
850 OECD – *Signatories and Parties*…
851 *Ibid*; HATTINGH, Johann – *The Impact of*… p. 235.
852 OECD – *Signatories and Parties*…
853 Australia, Canada, France, Germany, India, Indonesia, Japan, Russia, Saudi Arabia, South Korea and the UK.
854 OECD – *Signatories and Parties*…
855 *Ibid*.

Moving onto another important group, the EU, out of the 27 Member-States, 24 have already ratified the MLI and the remaining are signatories, depicting a wide acceptance [856].

On part IV's articles, the findings are harrowing, especially considering the EU's support to Action 7's solutions, as the reservations per article surpass half of the ratifications. Describing, 17 countries made reservations to article 12 MLI, 14 countries reserved their rights on article 13 MLI (Austria's, Germany's and Luxembourg's is limited to the anti-fragmentation rule), 22 countries made reservations to article 14 MLI (Ireland's, Lithuania's and the Netherlands' is limited to the exploration/exploitation of natural resources), and 14 countries reserved their right not to apply article 15 MLI[857].

Regarding article 13 MLI, the previous pattern is nearly lost, as option A has only a slight advantage over option B (7 to 5), with Portugal not choosing any option[858].

Finally, looking at the top countries that share a close economic and trade relation with Portugal (Spain, Germany, France, the UK and the Netherlands), only Spain has yet to ratify the MLI[859].

As regards part IV's articles, among those that ratified the MLI, Germany, the Netherlands and the UK made reservations to article 12 MLI; on article 13 MLI the UK did not elect any option and Germany made a partial reservation; and France, Germany, the Netherlands and the UK made reservations to article 14 MLI (the Netherlands' is limited to the exploration/exploitation of natural resources)[860]. On article 13 MLI's options, France elected option B, while Germany and the Netherlands chose option A[861].

Based on our analysis, the concerns raised on the MLI's inconsistent implementation as a consequence of its flexibility have become true, as a significant number of countries have made reservations to the MLI's PE articles.

Also, the majority of countries making reservations to part IV are developed countries, and not emerging or developing countries, which could either illustrate

[856] *Ibid*.
[857] *Ibid*.
[858] *Ibid*.
[859] *Ibid*.
[860] *Ibid*.
[861] *Ibid*.

that their DTTs are already compliant with the MLI or that, amongst other causes, those countries are treading carefully on their level of commitment to the MLI, waiting on their counterparts' positions[862].

Another conclusion that can be drawn from our selected analysis is the odd pattern of reservations to article 14 MLI and its anti-splitting specific anti-abuse provision, signalling that countries prefer to address this issue without an actual provision.

Considering the outcome of our analysis on the poor and uncoordinated implementation of Action 7's solutions, the hope now relies on both domestic legislation amendments and bilateral negotiations of DTTs.

Our analysis on the MLI and its implementation function from the PE concept's perspective is terminated, having addressed both the core aspects of this novel instrument, which promised more than what it has been effectively delivering to the international taxation system, and each of its provisions on the PE concept.

This chapter addresses the first aftershock following the BEPS Project's quake on the international taxation system, which presented a rather modest intensity on the PE concept, perhaps for being the first one. Moving forward, we will address another aftershock and assess its impact on the PE concept.

3.4. Preliminary conclusions

From our work above, it is possible to draw some conclusions on the MLI and its effects on the PE concept.

The MLI is a remarkable cutting-edge multilateral convention that resulted from unparalleled global political (and academic) support to a unique solution capable of delivering solutions against the BEPS malice in the international taxation system promptly, consistently, and harmoniously on over 3500 DTTs without cumbersome multiple domestic implementation processes.

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[862] DE WILDE, Maarten Floris – *Lowering the Permanent*… p. 566; KLEIST, David – *The Multilateral Convention*… p. 44; BRAUNER, Yariv – *McBEPS: The MLI*… pp. 10-11, 13; HATTINGH, Johann – *The Impact of*… pp. 239-240; AUSTRY, Stéphane – *Chapter 12: PE*… pp. 490-492; SMITH, ANDREW M. C. – *The New China*… pp. 441-442, 446-447.

The BEPS Project's validity and success hinges on the implementation of its solutions and Action 15 enabled the MLI as the vessel designed for the implementation of some of those solutions, including those of Action 7.

There is already a certain level of participation from the international community in the MLI and Action 7's solutions have begun to apply across CTAs, with the MLI standing side-by-side with CTAs instead of replacing them. The relationship between the MLI and CTAs is unique within the international taxation system, boasting an apparent harmonious coexistence with a prevalence of the MLI while providing an added level of complexity for interpreters.

The MLI is a notable aftershock to the BEPS Project in relation to the PE concept for its unique multilateral approach, which enables a potential massive update of this concept across the DTT network.

However, the MLI's life and support came at a cost, *i.e.*, it became an overly complex multilateral convention dependent on a fragile "matching" system, based on options and alternatives elected by signatories/parties through notification processes, to produce its effects.

Effectively, the MLI's design entails that a myriad of features need to be carefully aligned for it to modify a CTA provision on the PE concept, leaving several doubts regarding its effectiveness and success as Action 7's implementation vessel.

Uncharacteristically, the MLI might be a remarkable Trojan horse for further artificial avoidance due to its patchy delivery system derived from its profuse flexibility, supposedly a key asset with the deployment of opt-in clauses, reservation/opt-out clauses and alternative solutions.

Flexibility emerges as the Achilles heel of the MLI's synchronised and consistent implementation of anti-BEPS measures, especially for those on the PE concept. The MLI's capability mostly remained at a theoretical level.

The lack of wide consensus is a cause of the MLI's inability to implement Action 7's solutions, first with Action 7 not being a minimum standard and providing alternative options, and last with its overly complex flexible system.

Another drawback of the MLI comes from it being an added layer of rules within the international taxation system, as it applies together with CTAs (modifying the

application of the provisions or superseding them, based on novel compatibility clauses), adding to domestic legislations and DTTs, already plenty.

Additionally, the MLI is not a clear straightforward transparent instrument that is easily analysed and interpreted, comprising vague and subjective elements that could harm legal certainty.

Nonetheless, the MLI should be revered as a humungous cutting-edge legal instrument that successfully confirmed that a global-scale forum with developed and developing countries on equal footing and an instrument for international tax reform are possible and a valid path, being this one of its few achievements.

Yet, the MLI's success should not be limited to its form as it was an ambitious endeavour, but little was presented. Instead of a first prize trophy, it won a participation commendation. On the other hand, as a first proper prototype, the MLI is a proven concept, with room for improvement to achieve the expected prominence.

Profound modifications to the MLI are difficult to achieve considering that for those to be executed a Conference of the Parties to the MLI needs to convene and approve such modifications, which would then be subject to domestic implementation processes, therefore substantial support would be required.

Nevertheless, learning from the MLI's imperfections and glitches could drive the stakeholders to develop a new multilateral instrument for international tax reform that bears less flexibility and is still capable of reaping sufficient support and acceptance worldwide, thus bringing greater certainty and consistency to the international taxation system.

This path requires critical thinking from all stakeholders, learning from the MLI's experience and all its elements, facing the MLI as a trial run to shed concerns, doubts and fears that prevent further global commitment and consensus, even if for some areas multilateralism is nearly unattainable.

The MLI succeeded in adequately transplanting Action 7's solutions to its articles, without distorting their meaning or wording, merely adjusting them for cross-referencing so that these articles could apply to CTAs regardless of their origin, thus expanding its reach across the DTT network.

However, as Action 7's enforcer throughout the DTT network, the MLI has not been successful, with the notification process denoting plenty of inaction from countries and also reservations towards its part IV.

As for the MLI's outcome vis-à-vis the PE concept, generally, its measures mostly intensify the concerns raised on Action 7 regarding the nefarious effects from the constant lack of proper guidance, the proneness to uncoordinated and inharmonious implementation, as well as the shortcomings of some measures as there was no actual improvement.

The MLI's design has proven to be inadequate to carry out the BEPS Project's objectives of a coordinated and synchronised implementation of Action 7, it has merely provided a swift vessel producing patchy work.

Moreover, considering the detailed work conducted by practitioners, enterprises, scholars and organizations on Action 7's merits and downfalls, raising concerns and critique on the solutions presented, and offering improvements, more was expected from the MLI than an overly complex vessel with a questionable ability to effectively implement measures. The MLI could have been more than a cartridge for the BEPS Project's Actions.

Besides being a casing, the MLI could have reviewed and improved Action 7's solutions according to the international tax community's contributions, so that it could implement a refined offensive against the artificial avoidance of PE status, instead, we only saw a glimpse of such work on article 14 MLI.

Resorting to an illustrative analogy, the MLI might just be an exaggerated secure glass casing used to hold the BEPS Project's Fabergé eggs, including Action 7, and display them to qualifying and "matched" visitors, regardless of the fragility or damages present in Action 7's egg.

The MLI should be more than just that casing, it should also be the curator that tends and restores worthy pieces whenever damages exist prior to display, as damaged pieces produce negative effects.

Returning to reality, the WP1's work on Action 7's solution against splitting-up of contracts strategies, enshrined on article 14 MLI, should have been more detailed and conducted on all solutions, as the limitations on Action 15's mandate should not apply in this regard.

In this sense, the MLI's outcome as a blunt vessel for implementation of approved measures should be regarded as a success, on the other hand, as an evolved solution to improve the international taxation system that considers the ramifications of the implementation of those measures, we cannot argue that it is a success. This is a path worthy of being followed, even if it would exceed the *ad hoc* Group's mandate or the MLI's initial purpose, which is also doubtful.

On the MLI implementation of Action 7, the current state of the global commitment behind part IV is evidently far less than ideal. Considering the sheer importance of the stakes at hand it does not suffice to have a near 50% acceptance of the MLI provisions and even more so when that only translates to *circa* 650 modified DTTs, less than 20% of the DTT network.

These numbers are a daunting vision of the MLI's early years as they mirror the countries approval of this path and their willingness to cooperatively update the PE concept, however, the MLI is not the only method to implement Action 7 and the reality might be brighter.

With the completion of this Chapter on the first noteworthy BEPS Project's aftershock on the PE concept, our work will continue onto the second, and last, noteworthy aftershock.

CHAPTER 4: THE PERMANENT ESTABLISHMENT CONCEPT IN THE 2017 OECDMC – The New Standard

In the wake of the first aftershock of the BEPS Project's quake, a second tremor followed and continued the reshaping of the international taxation system, crystallizing a new standard for the PE concept within it following Action 7's guidelines.

As the MLI, the 2017 update to the OECDMC[863] evidences concerns with the implementation of the treaty-related measures proposed in the BEPS Project's relevant Actions[864]. As seen, although the MLI is the prime method to implement these measures, these can also be adopted through bilateral renegotiations, where an updated OECDMC plays a critical role[865].

Considering the OECDMC's sheer relevance, its update in line with the BEPS Project's outcome was a natural step, to complement the MLI and to intensify the implementation of that outcome across the DTT network, both on the existing DTTs and on the ones yet to be negotiated and entered into[866]. Like the MLI part IV, the 2017 OECDMC update's connections with Action 7 are notorious.

As noted, the OECDMC is the primordial model used by countries to negotiate and draft their DTTs, holding a predominant position, followed by the UNMC[867]. Therefore, in line with the OECD's pledge for ongoing work on the improvement and implementation of the BEPS Project's measures, the OECDMC had to be updated to maintain its standing within the international taxation system, reiterate those measures' significance and expand their reach across the DTT network[868].

Ultimately, the likelihood of consistent and harmonious implementation of Action 7's measures increases with the OECDMC's 2017 update, with additional pressure over the stakeholders to adopt these measures and with them being included in the common basis for DTT negotiation.

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[863] OECD – *Model Tax Convention on Income and on Capital: Condensed Version 2017*. OECD Publishing. Paris, 2017. Available at: https://doi.org/10.1787/mtc_cond-2017-en
[864] OECD – *Model Tax Convention*… 2017. p. 11.
[865] GILLESPIE, John – *The Base Erosion*… p. 25.
[866] *Ibid*.
[867] KOSTIC, Svetislav V. – *Chapter 3: New*… p. 1; KLEIST, David – *The Multilateral Convention*… p. 34.
[868] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 241.

For the new PE concept's standard to be cemented within the international taxation system following the anti-BEPS quake, the MLI's tentative mass overhaul of DTTs does not suffice, it requires reinforced mechanisms to effectively change such a key component, starting with the very base, *i.e.* the OECDMC[869].

In this context, in November 2017, the OECD released the updated OECDCMC, which also brought a significant shift on the OECDMC's purpose by adding to the prevention of double taxation, the prevention of opportunities for double non-taxation and the prevention of tax evasion and avoidance[870].

Although non-binding, updating the OECDMC with Action 7's proposed standard sends a clear message to all stakeholders that there is a new PE concept's standard and that it should be included in their DTTs, thus improving the fight to prevent the artificial avoidance of PE status.

Furthermore, contrary to the MLI, the 2017 OECDMC did not limit itself to the mere transposition of Action 7's measures, in fact, it went beyond them and introduced adjustments and clarifications throughout article 5[871][872]. However, the update is not without its particularities, namely regarding the MLI.

Herein we shall analyse the 2017 OECDMC's impact on the 2014 OECDMC's PE concept vis-à-vis Action 7's solutions, notably on how faithful to Action 7 is the 2017 OECDMC and whether or not it has addressed the concerns raised in Chapter 1.

Following the same methodology, our analysis focuses on article 5 2017 OECDMC, based on its sequence, and addresses the modifications made to each of its elements, showcasing wording amendments where they occur and explaining the Commentary's revision.

Up until this thesis's completion, the 2017 OECDMC is the last major impact on the PE concept and aftershock to the BEPS Project. It is also relevant to note that both the MLI and the 2017 OECDMC are relatively new in the international taxation

[869] SHTROMBERG, Alexandra – *Managing Permanent Establishment*… pp. 20-21.
[870] OECD – *Model Tax Convention*… 2017. p. 15.
[871] SHTROMBERG, Alexandra – *Managing Permanent Establishment*… pp. 20-21.
[872] Although not within this thesis's scope, apart from small clarifications in accordance with the main modifications, the Commentary on electronic commerce and the services PE remained mostly untouched by the 2017 OECDMC.

system, hence court cases where their provisions have been argued and decided are rare.

4.1. Article 5 (1) 2017 OECDMC

As noted, article 5 (1) OECDMC is the pivotal element of this article and of the PE concept, as it establishes the physical PE concept and its various key elements, each leading to a test that must be met to reach the PE status.

Furthermore, we demonstrated that article 5 (1) 2014 OECDMC has some limitations that could affect its interpretation and potentially lead to disputes over its application in concrete situations, thus requiring additional guidance.

Therefore, seizing the opportunity presented by the BEPS Project, the OECD revised article 5 OECDMC entirely, some provisions in a greater extent (those connected with Action 7) and others with a more surgical review. Article 5 (1) OECDMC falls within this last group of provisions.

4.1.1. The update

Article 5 (1) OECDMC's 2017 update was carried out strictly on its Commentary, without any adjustment to its still suitable wording.

This update's approach was focused on clarifying certain aspects, such as the *situs* test and the "at the disposal" element, and adding examples to the existing guidance, thus enhancing this provision's clarity and certainty[873]. Also, it must be noted that the pre-existing Commentary was left unscathed, with only minor rearrangements, thus reinforcing the valour of the existing guidance.

The OECD sought to clarify that the scope of an all facts and circumstances assessment should be circumscribed to the point in time where such facts and circumstances, such as a business arrangement, are in place, absent of concern with previous or future events that alter the way a person carries on its business in source countries[874].

[873] GALLO, Giulia – *Chapter 11: Active*… p. 6.
[874] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 8.

With this stance, the OECD appears to favour a static approach to the assessment of PE status, without valuing eventual modifications to existing arrangements by the relevant persons, over a dynamic one, where previous actions and strategies are considered as well. This apparent shift in methodology differs from Action 7's findings, as it targeted commissionaire arrangements that replaced traditional buy/sell arrangements, finding the former to be abusive mostly due to such replacement[875].

This update also clarified the PE concept's autonomy and transversal relevance within the OECDMC, since the assessment of PE status ought to be conducted independently from the qualification of the income perceived and the applicable income provision, even where the existence of a PE might not be relevant for profit attribution under the relevant provision, for instance, on real estate and article 6 OECDMC and on interest and article 11 (4) and (5) OECDMC[876].

Furthermore, the guidance on the "at the disposal" element of the physical PE concept has been expanded, which, as stated, is particularly relevant for most of its tests[877].

With effect, the new Commentary clarifies that under the "at the disposal" element there are three core features that should be verified when assessing whether a certain place may be deemed to constitute an enterprise's physical PE, *i.e.* (i) the effective power that an enterprise has to use such place, (ii) that enterprise's presence therein, and (iii) the activities it performs therein[878].

This new guidance also includes examples, such as that a place might be deemed to constitute a physical PE where an enterprise has a legal title over it and uses it exclusively for carrying on its business activities, even if solely through subcontractors (for instance, an internet-based hotel enterprise that subcontracted a company for the on-site operations), similarly, where an enterprise uses a determined location, owned by a third-party or shared with other enterprises (like co-working spaces or corporate hubs), and carries on its business activities therein

[875] OECD – *Preventing the Artificial*… p. 15.
[876] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 9.
[877] GALLO, Giulia – *Chapter 11: Active*… p. 6.
[878] *Ibid*; OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 12.

regularly and for a lengthy period of time, such location might also be deemed to be a physical PE for that enterprise[879].

On the contrary, where an enterprise's presence on a specific location is sporadic or random, such as employee visits between associated enterprises without extensive work at each other's premises, or where an enterprise does not use a location nor has a right over it, such as a supplier's or contract-manufacturer's factory, hardly can it be assumed that such locations are at the enterprise's disposal and that they should be deemed to constitute a PE, despite the enterprise receiving the products produced therein[880].

Still within this element, the 2017 Commentary provides relevant guidance on a particular current situation with growing relevance in the new global economy: home offices and teleworking. Although this is a relatively modern reality, the chances of a home office resulting in a physical PE for an enterprise still reside in the same relatively stable elements of article 5 OECDMC.

Therefore, those elements should be applied to this specific situation and once again the "at the disposal" element is crucial, making clear that the mere fact that an enterprise's business is partly carried on at a person's (*e.g.*, employee, director) home office does not automatically result in that location becoming a physical PE for that enterprise since that location cannot be said to be at the enterprise's disposal simply because a person uses it[881].

The home office assessment as a physical PE follows article 5 OECDMC's standard approach, all facts and circumstances casuistic analysis[882].

Most home office situations are so sporadic or random that the person's home office cannot be deemed to be at the disposal of the enterprise for carrying on its business activities, such as in situations of employee sickness or parental leave, or when a country/region decrees a lockdown for public safety reasons[883].

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879 OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 12, 40; GALLO, Giulia – *Chapter 11: Active*… pp. 6-7.
880 OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 12; GALLO, Giulia – *Chapter 11: Active*… p. 6.
881 OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 18; GALLO, Giulia – *Chapter 11: Active*… p. 6.
882 OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 18.
883 *Ibid*; GALLO, Giulia – *Chapter 11: Active*… p. 6.

Differently, when the enterprise's business is carried on through that person's home office continuously, the physical PE claim becomes stronger, especially if the circumstances reveal that the enterprise requires that person to use its home office to carry on the former's business activities, for instance, by not providing that person with an office when one is needed[884].

Also, it matters to highlight that in case an office was provided, the PE risk would simply shift from the home office to the enterprise's office. Still, as the Commentary points out, most of the traditional home office situations relate to auxiliary activities, which could be salvaged by article 5 (4) 2017 OECDMC[885].

From the Commentary's example, an important element for the assessment of potential home offices physical PE can be extracted, namely on whether or not the relevant enterprise (employer or otherwise) requires, directly or indirectly (*e.g.*, by not providing an alternative), that person to use its home office to carry on that enterprise's business activities (the compulsory home office test), which provides a helpful indication for concrete cases and brings clarity to these situations[886].

Furthermore, the Commentary's new examples also address cross-frontier workers, clarifying that the location of the offices made available for the person to work is relatively irrelevant, even if they are in the frontier country where the person is not a resident, subject to the limitations of cross-frontier workers and the compulsory home office test[887].

Besides unravelling the "at the disposal" elements, the new Commentary also provides additional examples to this article's other tests for greater clarity, particularly to the *locus* and the *tempus* test, with a simpler reference to employees carrying on business activities for an enterprise while being employed by another related enterprise for administrative reasons, which should not create a PE for the latter[888].

On the first test, although it already resulted from the parameters of this test, the 2017 update establishes that a ship in navigation (in international waters or

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[884] *Ibid*.
[885] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 19.
[886] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 18-19; GALLO, Giulia – *Chapter 11: Active*… p. 6.
[887] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 19.
[888] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 39.

otherwise) cannot be a FPOB as it is not fixed, unless there is geographic and commercial coherence of its operation vis-à-vis a certain location, such as cruise ships or river sightseeing ships[889].

However, the Commentary clarifies that the result of the physical PE assessment on the ship shall taint the business activities carried on aboard such ship (shops, restaurants…), meaning that if the ship is deemed not to be a physical PE based on the lack of permanence at a given location, thus failing the *situs* test, so will the other business activities[890].

This equal treatment policy might be extrapolated to similar situations of umbilical connections between business activities in an itinerary or movable environments, such as fairs, circuses, music or theatre tours and conventions.

As regards the *tempus* test, the new Commentary addresses two exceptions to the common country practice of a 6-month threshold for this test, where activities last for less time, but the test could still be met[891].

The first is recurrent activities, based on an example of seasonal activities where due to weather conditions (artic location) an enterprise cannot carry out its business activities for more than 3 months in a row, but does it recurrently for a 5-year period at the same location, thus each period of time should be aggregated for purposes of this test; also, recurring activities due to the nature of the business (such as festivals) should follow the same principle[892].

The second addresses cases where the 6-month threshold is not met but the business activity is exclusively and entirely carried on in the relevant country due to its very nature, evidencing a strong connection with that country, to which an example is provided of a one-off business activity involving the temporary exploration (4 months) of a house in a country, by individuals resident in another country, as a cafeteria for a local documentary that will also last for 4 months, after which time the cafeteria will cease to exist, thus completing that business activity[893].

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[889] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 26.
[890] *Ibid*.
[891] GALLO, Giulia – *Chapter 11: Active*… p. 7.
[892] *Ibid*; OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 29.
[893] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 30; GALLO, Giulia – *Chapter 11: Active*… p. 7.

Nevertheless, the above example must be distinguished from cases where an enterprise has a catering service with multiple facilities in its country, but for 4 months it explores a cafeteria in another country, in this case, the 6-month threshold exception should not apply, as the cafeteria activity appears to have a true temporary nature[894]. This example clarifies the nature of a true one-off and novel business activity.

The last features tackled by the 2017 update relate to clarifications on the notion of enterprise for purposes of article 5 OECDMC, reinforcing that "enterprise" refers to any enterprise carried out by a resident of a Contracting State regardless of its legal form[895]. Also, project collaborations constituting a separate enterprise is a matter of fact and domestic law, as is the case of joint ventures being deemed to be a separate enterprise[896].

Lastly, the new Commentary reinforced its position on fiscally transparent partnerships, maintaining the look-trough approach to the partners of that partnership and their individual residence countries[897].

Our review of article 5 (1) OECDMC's 2017 update is complete and it reveals that the OECD sought to provide additional guidance and clarity to the physical PE concept, with precise remarks and new examples on pivotal elements and features that could otherwise be a cause for concern or dispute, thus enhancing the PE concept beyond the BEPS Project's shackles.

Notwithstanding, the OECD could have taken bolder action and also address the concerns raised by stakeholders, some of which commented on Chapter 1. Following the BEPS Project's immense support, the OECD had the conditions to be on the vanguard of innovation on international taxation and spearhead the improvements to the PE concept, such as a clear time threshold or a minimum profit threshold for a physical PE to be deemed to exist.

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[894] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 30.
[895] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 42.
[896] *Ibid*.
[897] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 43.

4.2. Article 5 (2) 2017 OECDMC

Our analysis now advances onto article 5 (2) 2017 OECDMC, which, as explained, contains an illustrative non-exhaustive list of typical physical PEs without expanding this concept's scope or constituting a deeming provision.

Further to our Chapter 1 remarks, article 5 (2) OECDMC is undoubtedly lost in time when considering the examples portrayed and the current stage of the world's economy and technology, hence this provision needs to be updated and kept dynamic, otherwise it could become obsolete.

4.2.1. The update

Despite the need to bring article 5 (2) OECDMC to current times, the OECD chose a different path, as it failed to make any modification to the wording and only made a simple modification to the Commentary[898].

With effect, the 2017 update to this provision's Commentary merely reinforces that this provision's list is simply an exemplification of places of business and that article 5 (1) 2017 OECDMC's tests still need to be met for a PE to be deemed to exist, subject to article 5 (4) OECDMC's carve-outs[899].

In all fairness, this additional exactitude on the Commentary could already be extrapolated from the previous version and the consensus built around this provision.

The apparent focus of the OECD's work on this provision was more to somewhat codify the countries consensus than to innovate or improve this ageing provision, hence the OECD's work herein ought to be questioned.

[898] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 45.
[899] *Ibid*; GALLO, Giulia – *Chapter 11: Active*… p. 8.

4.3. Article 5 (3) 2017 OECDMC

Our review of the OECDMC's 2017 update will venture onto article 5 (3) OECDMC, the first provision also targeted by Action 7, notably to include an anti-splitting specific anti-abuse provision in its Commentary.

As commented, article 5 (3) OECDMC houses the project PE concept, which is intrinsically connected with qualifying business activities conducted on building sites/projects.

This provision marks the first deviation from the physical PE concept, as it foresees an objective minimum time threshold, where a PE shall only be deemed to exist if an enterprise carries on qualifying business activities at a building site/project for more than 12 months.

We had pointed out that this provision should be revised to trim its inefficiencies, particularly on the ease with which enterprises could bypass the minimum time threshold and avoid PE status, an aspect that Action 7 addressed bluntly by proposing the abovementioned anti-splitting rule.

In this sense, it matters to review how the OECDMC embraced Action 7's solution in its midst and whether or not it improved said solution.

4.3.1. The update

Herein, the OECD also abstained from modifying this provision's wording and opted to concentrate its efforts on the Commentary, where it included the anti-splitting specific anti-abuse provision previously explained.

From the OECD's work on this provision's Commentary, it is immediately clear that it has embraced Action 7's provision against the splitting-up of contracts and went beyond it with the subtle efforts of WP1, as noted[900].

With effect, article 5 (3) 2017 OECDMC's anti-splitting specific anti-abuse provision is a twin of article 14 MLI's tweaked version of Action 7's optional solution,

[900] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 52; OECD – *Explanatory Statement To*… pp. 45-46.

paired with Action 7's reduced guidance[901]. As commented, WP1's subtle modification deserves praise for providing clarity to an already acceptable provision. For the sake of conciseness, we refer to Chapter 2 and 3's comments and analysis on this provision.

Nonetheless, we reiterate that this provision would be far more effective in preventing the splitting-up of contracts and artificial avoidance of PE status if it was directly inserted in article 5 (3) 2017 OECDMC's wording and if it was not an optional provision, as the leeway for divergent country practices would be lesser than the one arising from keeping it hidden in the Commentary[902].

Therefore, MNEs can explore latitudes where this provision is absent and put them to use for their artificial avoidance purposes, thus perpetuating BEPS practices and diminishing Action 7's outcome and the taxation equilibrium.

Furthermore, although the 2017 update adjusted the anti-splitting rule's wording from Action 7, the OECD still renounced to listen to the stakeholders' concerns over this provision's lack of guidance and kept it as initially drafted, which is surprising considering that WP1 had already considered that this provision needed revision, yet it must have found that the guidance provided was sufficient.

Following our previous Chapters' remarks, we cannot agree with the OECD's stance in this regard, additional guidance and examples are essential for this rule's effective and efficient implementation and application across the international taxation system, especially considering its strong subjective connotation[903]. The OECD should be proactive and not wait for disputes and court decisions (often divergent amongst themselves) to provide the necessary guidance.

The OECD's inaction towards the anti-splitting rule's guidance is even more striking because the OECDMC 2017 update was not limited to this provision's implementation, it went beyond it and clarified others elements of the project PE concept, with additional guidance and examples[904].

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[901] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 52-53; GALLO, Giulia – *Chapter 11: Active*… p. 10.
[902] GALLO, Giulia – *Chapter 11: Active*… p. 10.
[903] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 53.
[904] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 54-56.

The OECD's clarifications to this provision's existing Commentary are mostly express references to the already common understanding of its interpretation, such as that the contractor may subcontract all, or parts, of a relevant project to other enterprises and that the time these spent working at that building site/project will be computed in the contractor's PE status assessment[905].

To apply this contractor/subcontractor anti-abuse provision and have the subcontractors' time be considered in the general contractor's PE status assessment, the building site/project should still be at the latter's disposal when subcontractors are working therein, hence aligned with the adjustments on the "at the disposal" element, which also marks the time threshold's commencement date[906].

This reiterates that in the project PE, the physical PE's tests still need to be verified to a certain extent[907].

As such, the mentioned "at the disposal" element's three core features should be considered, also, the Commentary provides some factors that may evidence that a building site/project is "at the disposal" of the general contractor, *i.e.* the legal possession, access and use control, and responsibility over the events occurred therein during the period that subcontractors operate[908].

In essence, the three factors provided are adaptions to the project PE of the physical PE "at the disposal" element's three core features.

Additional guidance was also provided on the relevant moments for the conclusion of the 12-month test's computation, clarifying that generally, that moment should coincide with the delivery of the building/project to the client, provided that no work is still required to complete it[909].

The practical assessment of these moments is not straightforward and could be prone to divergent interpretations, therefore, common examples of actions in a building site/project that could impact the 12-month test assessment are provided.

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[905] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 54; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 79-80.
[906] GALLO, Giulia – *Chapter 11: Active*… p. 9; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 79-80, 83.
[907] GALLO, Giulia – *Chapter 11: Active*… p. 9.
[908] *Ibid*; OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 54; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 79-80.
[909] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 55; GALLO, Giulia – *Chapter 11: Active*… p. 10; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 84.

The first relates to the building/project testing, a natural occurrence of any building/project activity, which should be considered as being part of the qualifying activities at the building site/project and that time should be included in the 12-month test's computation[910].

In contrast, for instance, activities carried out on a site upon the completion and delivery of the building/project under a warranty for repairs, should not be considered in the computation of the initial building/project activities, likewise, the time spent on the site for training the client's employees to operate the building/project should not be considered[911].

In any case, activities performed after the initial qualifying building/project activities that typically should not be considered for the 12-month test should still be subject, and surpass, the anti-splitting specific anti-abuse provision commented, otherwise, this provision applies and that time will be computed[912].

The final adjustment to article 5 (3) 2017 OECDMC addresses a concern with its interpretation regarding partnerships by providing a clear example of its application to partnerships, those legally recognised, and its effect on the partners, reinforcing the standard look-through approach to the relevant partner by applying the relevant DTT between the Source Country (where the partnership has the building site/project) and the partner's country of residence, even if it leads to different outcomes between partners vis-à-vis the same partnership, *e.g.* A and B, residents of country A and B, respectively, are partners in partnership X, which operates a building site in country X, the A-X DTT has a 6-month threshold and the B-X DTT has a 12-month threshold[913].

This example is another obvious signal of the nefarious result of divergent country practices, in this case on the minimum time threshold, where countries often deviate from the standard 12-month threshold.

Having addressed article 5 (3) OECDMC's 2017 update, it stands clear that there has not been a breach in the path taken but a continuity, as it generally maintains

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[910] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 55; GALLO, Giulia – *Chapter 11: Active*… p. 10.
[911] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 55.
[912] *Ibid*; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 84.
[913] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 56; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 81-82.

the pre-existing Commentary and adds further guidance and examples, and also introduces a novel optional provision, inspired in the existing contractor/subcontractor anti-abuse provision.

Despite addressing the key concern raised in Chapter 1 through Action 7, the 2017 update still failed to improve Action 7's solutions and resolve its issues, mostly connected with the anti-splitting rule's optional element and the absence of proper guidance.

Therefore, our previous critiques remain generally applicable herein, particularly those of Chapter 2.

4.3.2. 2017 OECDMC vs Action 7 and MLI

With article 5 (3) 2017 OECDMC presented and no real innovation vis-à-vis the 2014 version other than the anti-splitting rule, it matters to address how the OECDMC's update compares to both Action 7 and the MLI.

In this sense, other than a slight adjustment to the anti-splitting rule's wording, in line with article 14 MLI, article 5 (3) 2017 OECDMC is indistinguishable from Action 7's solutions[914].

Similarly, the 2017 update fails to present any innovation vis-à-vis article 14 MLI, standing as a mere reproduction, or even a step backwards since the anti-splitting rule no longer stands as a separate provision and is relegated to the Commentary, keeping its optional nature[915].

The OECD's inability to attach the anti-splitting specific anti-abuse provision to article 5 (3) 2017 OECDMC's wording evidences the lack of consensus present around this provision, even among OECD countries, similar to the BEPS Project. This lack of consensus over one of the PE concept's scourges is unfortunate.

If a lack of consensus on a broad setting such as the BEPS Project could be somewhat expected, with deep economic and political differences between its members, the same cannot be said amongst the OECD and its members, where a step

[914] GALLO, Giulia – *Chapter 11: Active*… p. 10.
[915] *Ibid*; HATTINGH, Johann – *The Impact of*… p. 242.

forward could have been taken to point, and lead, the way to strengthen the international taxation system against BEPS practices.

Furthermore, it is not coherent to have the anti-splitting rule as a stand-alone measure in the MLI, although optional, and afterwards, in the 2017 OECDMC, demote it to the Commentary, keeping its optional nature[916].

This stance conveys a mixed position over the anti-splitting rule, from a relevant provision in the prevention of the artificial avoidance of PE status to a minor suggestion for an alternative route. Such a position from the OECD can mislead countries on this provision's importance and devalue it from its original role.

As stressed throughout our work, the prevention of the artificial avoidance of PE status requires a coherent and harmonious implementation of the relevant rules via a unified front, however, it is more difficult to request countries to uphold and abide by such goals and agenda when the organizations that originated this movement fail to do so.

On the prevention of the artificial avoidance of PE status, the 2017 update to article 5 (3) OECDMC chose to adopt the bare minimum with the simple transposition of Action 7 and the MLI's solutions, instead of continuing to be on the vanguard of innovation and improvement of the international taxation system.

As regards this update's remaining features, additional guidance and examples should be praised and the ones provided clarify aspects of the project PE that could be the cause of discussions or disputes, hence we acknowledge and value the decision to go beyond the mere adoption of Action 7's solutions and actually improve the project PE.

4.4. Article 5 (4) 2017 OECDMC

Continuing with our analysis of the OECDMC's 2017 update, our focus will steer towards article 5 (4) OECDMC, one of the provisions most affected by Action 7.

[916] HATTINGH, Johann – *The Impact of*… p. 242; ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… p. 31.

Article 5 (4) OECDMC, the specific activity exemptions provision, foresees exceptions to PE status for preparatory or auxiliary activities, which was a safe harbour for MNEs devoted to BEPS practices, as they exploited certain countries' interpretation of this provision to their behalf and also fragmented their activities amongst related persons so that each individual person/activity could be eligible for this safe harbour[917].

In this context, Action 7 proposed a significant overhaul to this provision, including the removal of the automatic qualification as preparatory or auxiliary for certain listed activities, even if merely optional, and the adoption of an anti-fragmentation rule, which should nullify the effects of the MNEs' artificial fragmentation of coherent business activities among related enterprises by removing the benefits of this provision.

Action 7's work targeted most of the concerns raised on the 2014 version of this negative catalogue, namely on the fragmentation of activities amongst group companies and detailed guidance on the preparatory and auxiliary concepts.

However, some issues remained untouched and several new ones arose, therefore, we will review the 2017 update to article 5 (4) OECDMC considering Action 7's work and the MLI, and ascertain whether Action 7's imperfections were addressed.

4.4.1. The update

Article 5 (4) OECDMC's 2017 update is the first to amend the provision's wording and also brings substantial modifications to its Commentary, following the wording modifications.

With effect, article 5 (4) 2017 OECDMC's wording embraces Action 7's solutions to prevent the artificial avoidance of PE status through the specific activity exemptions provision by removing the automatic qualification as preparatory or auxiliary from the first compartment activities and adding the pioneering anti-fragmentation rule:

[917] GALLO, Giulia – *Chapter 11: Active*… p. 11.

"*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;*
f) *the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e,*

provided that such activity or, in the case of subparagraph f), the overall activity of the fixed place of business, is of a preparatory or auxiliary character

4.1 Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and

a) *that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or*
b) *the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,*

provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places,

constitute complementary functions that are part of a cohesive business operation."[918]

This provision's wording is an exact replica of the one proposed by Action 7, without any consideration for the concerns raised regarding the anti-fragmentation rule's overly extensive scope. So, for brevity's sake, we refer to Chapter 2's analysis and critique of both solutions.

Still, the OECD deserves critique and should be questioned over the lack of additional work on the imperfect solutions resulting from Action 7 and the MLI, particularly considering the stakeholders' echoes in this regard. Although it is vital to present solutions, it is just as vital to review and improve them when they bear nefarious side-effects, for them not to do more harm than good.

With article 5 (4) 2017 OECDMC's wording reviewed, due to the lack of modifications or innovation, our aim shifts towards its Commentary.

Despite having a redemption opportunity with the Commentary's update, the OECD did not seize it, since the majority of the amendments reproduce those proposed by Action 7 for the specific activity exemptions provision's new wording and the anti-fragmentation rule, with minor adjustments related with the closely related concept of article 5 (8) 2017 OECDMC[919].

Furthermore, this reproduction even includes the option for countries to adopt the undesirable alternative provision for the specific activity exemptions provision that salvages the automatic qualification of the first compartment as having a preparatory or auxiliary character, which should have been eradicated from the OECDMC, as it is a leading cause of BEPS practices within this provision[920].

It is also noteworthy that the 2017 update neglected to review and improve Action 7's solution despite the concerns raised and its dire need for enhancement and additional guidance for the novel concepts introduced therein, especially on the anti-fragmentation rule[921].

[918] OECD – *Model Tax Convention*… 2017.
[919] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 58-81.
[920] GALLO, Giulia – *Chapter 11: Active*… p. 12.
[921] GILLESPIE, John – *The Base Erosion*… pp. 35, 45-46, 48-50.

Once again, the 2017 update is mostly a blind transposition of Action 7's solutions without proper critical judgement over their application and side-effects and any consideration for the stakeholders' requests for improvement.

Therefore, we refer to the preceding Chapters analysis and critique on this topic, which has become substantially heightened since these solutions have been implemented in the OECDMC without care over their inefficiencies, meaning that our concerns are likely to verify and hinder the international taxation system.

Nevertheless, the 2017 update still dons a glimpse of improvement over Action 7's solutions, with novel guidance and examples that were not part of Action 7[922].

This new guidance has clarified that paragraphs (a) and (b) of article 5 (4) 2017 OECDMC also apply to any combination of the activities referred therein, meaning that a combination of storage, display and delivery would also be covered by each of the mentioned paragraphs, applying the same principle as paragraph (f) of this provision[923]. Again, this addition appears to merely codify common interpretation and understanding.

Still on paragraphs (a) and (b), these paragraphs' benefits may be granted regardless of whether the goods or merchandise have been sold (economic relation), the key element is whether the enterprise still has legal title over the goods or merchandise stored, delivered or displayed (legal relation), meaning that the moment of transfer of legal title becomes an important criterion, this is particularly pertinent for internet-based retailers that still require physical presence, like a warehouse[924].

The new Commentary also reinforces the gap between the PE concept and any form of concept that allocates taxing rights on pure digital/internet-based activities, as it stresses that "goods" and "merchandise" within this provision refer only to tangible property (other than immovable property) and expressly excludes data, but not the tangible property where such data may be stored (such as DVD's), aligned with the OECD's position on servers[925].

[922] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 66, 72, 74.
[923] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 66.
[924] *Ibid*; GILLESPIE, John – *The Base Erosion*… pp. 28-29.
[925] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 66.

Through this addition, the OECD has rid this safe harbour provision of potential abusive interpretations to apply it to dematerialized assets and data in connection with its potential application to the tangible property that contains such assets, like servers, at the same time it clearly removes immovable property from its scope[926].

Continuing with the updates that do not stem from Action 7, we note that one occurred due to the modifications to the DAPE concept. As commented, sales support offices or market services companies may surpass the DAPE threshold and achieve PE status, contingent on their effective role and involvement in the conclusion of contracts by the principal.

Within this context, the OECD clarified that an enterprise's office (and employees) actively negotiating relevant parts of contracts for the global sale of its products should not be regarded as having a preparatory or auxiliary character, as those activities are an essential part of that enterprise's business activities, thus active sales support offices and marketing services companies cannot shield themselves within article 5 (4) (e) 2017 OECDMC[927].

For instance, where a global internet-based retailer sets up a regional office in Europe to negotiate, or assist in the negotiation (such as on the products' type, quality or quantity) of, contracts for the sale of its products to clients in that region, that office may be deemed to be a PE, contingent on the verification of article 5 (1) 2017 OECDMC's tests.

The OECD succeeded in clarifying a potential debatable feature of the DAPE concept, both where it may and may not apply, since it is clear that those types of activities cannot claim refuge in article 5 (4) 2017 OECDMC, as this provision applies under the physical and DAPE concepts, and, at the same time, provides an example of an important role in contract negotiation[928].

In conclusion of this provision's 2017 update, the OECD added these two specific clarifications to article 5 (4) 2017 OECDMC's interpretation and application in anticipation of potential disputes and divergences, likely already raised by

[926] *Ibid*.
[927] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 72.
[928] *Ibid*.

stakeholders, thus bringing additional certainty to this provision and the PE concept.

However, many other features that should have been revised were left unattended and free to give rise to disputes and divergent country practices, especially considering the novel concepts and the particularly broad scope of the anti-fragmentation rule, resulting in a disproportionate blind provision that could go beyond artificial schemes, without having such need[929].

This inaction has materialized the concerns raised on the solutions now integrated into article 5 (4) 2017 OECDMC and is harming an otherwise suitable and likely efficient provision, a scenario that will continue to worsen with the continued implementation of this provision in DTTs.

4.4.2. 2017 OECDMC vs Action 7 and the MLI

Following our review of article 5 (4) 2017 OECDMC's 2017 update, it stands clear that there was a significant improvement vis-à-vis the 2014 version with both the elimination of the automatic qualification as having a preparatory or auxiliary character for the activities of this provision's first compartment, meaning that these will now have to surpass the preparatory or auxiliary test to benefit from the exclusion, and the anti-fragmentation rule, as a backstop provision that preserves this provision's sanctity against artificial segregation of cohesive business operations, both with the limitations mentioned.

With this background, it bears to assess how article 5 (4) 2017 OECDMC compares with Action 7 and how it relates to the MLI.

Starting with Action 7, it is evident that this provision's wording is a mere transposition of Action 7's proposed measures. On the other hand, the 2017 update to this provision's Commentary did not limit itself to the mere replication of Action 7's solutions, even though the vast majority of the new Commentary is a faithful copy of Action 7, there still was some minor additional work.

However, this additional work did not improve or remedy the worrying aspects addressed in Chapter 2, instead, the OECD focused on new aspects that could lead to

[929] GILLESPIE, John – *The Base Erosion*… pp. 35, 45-46, 48-50.

interpretational doubts or even disputes, thus anticipating the problem by trying to solve it beforehand.

The two new clarifications in article 5 (4) 2017 OECDMC's Commentary are most welcomed as they add clarity and certainty to this provision, something that continues to lack herein.

In this sense, it would have been better to have the 2017 update enhance Action 7's solutions and address the issues raised, particularly on the lack of guidance for novel concepts and the anti-fragmentation rule's broad scope[930].

As noted, most of the 2017 update truly embraces Action 7's solutions, both in the wording and the Commentary, thus raising questions on the effective added value of the OECD's work in this regard, where it has only added minor reasonable clarifications to article 5 (4) OECDMC.

On the other hand, when analysed together with the MLI, the differences between the two prime instruments for the implementation of the measures to prevent the artificial avoidance of PE status are notorious[931].

As stated, article 13 MLI adopts Action 7's proposed measures regarding the specific activity exemptions provision, however, countries are given three options, first, submit all paragraphs to the preparatory or auxiliary test (Option A), second, maintain the automatic qualification as having a preparatory or auxiliary character for the first compartment (Option B), or, third, opting for neither option A or B but keeping the anti-fragmentation rule[932].

While in article 13 MLI options A and B are presented on an equal footing, allowing countries to choose the option that best suits their interests, with the commented inherent problems; in the OECDMC's 2017 update, option A has been chosen as the prime measure, relegating option B to the Commentary as a potential alternative provision[933].

Albeit the OECD's 2017 update was unable to eradicate the optional measures, which lead to divergent country practices and loopholes for MNEs to explore, it still

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930 GILLESPIE, John – *The Base Erosion*… pp. 44-45, 48-50.
931 ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… p. 31.
932 GALLO, Giulia – *Chapter 11: Active*… p. 14.
933 HATTINGH, Johann – *The Impact of*… p. 242; ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… p. 31; KOSTIC, Svetislav V. – *Chapter 3: New*… p. 9.

succeeded in electing a suitable provision to prevent the artificial avoidance of PE status through the specific activity exemptions provision[934].

Nonetheless, the decisions taken in the MLI and the 2017 OECDMC could be misleading countries, since the two primary mechanisms for the implementation of Action 7's solutions are not harmoniously aligned, with different decisions taken regarding these mechanisms' wording [935].

As commented, the BEPS Project's lifeline lies with the coherent and harmonious implementation of the relevant DTT-related provisions within the DTT network, however, these objectives become more difficult to achieve when the implementation instruments, and their provisions, are not aligned, as in this case[936].

Considering that the OECD plays a pivotal role on both instruments, the occurrence of these unfortunate events is even odder[937]. In this context, we are left to question the OECD's work true intent on the success of Action 7 and the prevention of the artificial avoidance of PE status through current, and future, MNEs' practices.

Having completed the assessment of this provision's 2017 update vis-à-vis Action 7 and the MLI, it becomes clear that the 2017 update missed the opportunity to truly champion change and improvement on Action 7's solutions and article 13 MLI, instead, it replicated Action 7, with some good minor clarifications, and part of article 13 MLI, leading to a misalignment between both provisions[938].

Article 5 (4) 2017 OECDMC continues to don the concerns raised, lack of substantial guidance on its interpretation and application and the anti-fragmentation rule continues with a broad spectre that is not limited to artificial fragmenting, hence the OECD still has plenty of work on this imperfect provision to make it more than just suitable to reach its objectives, it must consider spillover effects[939].

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[934] GILLESPIE, John – *The Base Erosion*… p. 34.
[935] ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… p. 31; GILLESPIE, John – *The Base Erosion*… pp. 39-40.
[936] ALMEIDA, Luis M.; TOLEDANO, Perrine – *Understanding how the*… p. 31.
[937] *Ibid*.
[938] GILLESPIE, John – *The Base Erosion*… pp. 39-40.
[939] GILLESPIE, John – *The Base Erosion*… pp. 35, 44-46, 48-50.

4.5. Article 5 (5) 2017 OECDMC

With the review of article 5 (4) 2017 OECDMC and its Commentary completed, our work advances onto the review of the DAPE concept's relevant provisions, beginning with article 5 (5) 2017 OECDMC, which was significantly overhauled following Action 7's solutions, in parallel to article 12 MLI.

Article 5 (5) 2017 OECDMC contains the DAPE concept's definition, which is a pivotal concept under the PE principle and the international taxation system.

This concept's relevance comes where an enterprise lacks a physical location in source countries but is still economically active therein, continuing to carry out its business activity, although through a proxy, namely an agent. Where an agent qualifies as a dependent agent vis-à-vis the relevant enterprise in a foreign country, the latter shall be deemed to have a PE in that country, as there are a significant presence and economic activity therein[940].

The 2014 OECDMC's DAPE concept had several issues that were undermining its success and effectiveness in the current global economy, therefore, Action 7 took charge to significantly modify article 5 (5) OECDMC and strengthen it against artificial avoidance practices, mostly connected with commissionaire arrangements and divergent country practices.

Action 7 proposed solutions that targeted the artificial avoidance practices identified to render them ineffective, thus resecuring this concept's effectiveness. Action 7's solutions significantly lower the PE threshold by enlarging this provision's scope, focusing on the agent's activities on behalf of the principal and including an economic/substance approach to their relationship.

Through these proposed measures, some of the concerns raised about the 2014 OECDMC's DAPE concept were surpassed, and, at the same time, the identified BEPS practices and schemes were rendered futile, with an expected substantial increase in PEs due to the new provisions lower threshold. However, not all prior issues were addressed, and many significant others came from the new provisions, thus potentially damaging this concept.

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[940] GALLO, Giulia – *Chapter 11: Active*… p. 15.

Following the above, we will review article 5 (5) 2017 OECDMC to ascertain this provision's evolution, if any, vis-à-vis the critically flawed one from Action 7.

4.5.1. The update

Our analysis of article 5 (5) OECDMC's 2017 update, shall begin with this provision's wording, which is mostly a replica of Action 7's proposed wording, with the immensely lower threshold resulting from the subjective economic approach to the relationship between agent and principal and the former's activities on behalf of the latter:

"*5. Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6, where a person is acting in a Contracting State on behalf of an enterprise and in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are*

d) in the name of the enterprise, or

e) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or

f) for the provision of services by that 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 person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business (other than a fixed place of business to which paragraph 4.1 would apply), would not make this fixed place of business a PE under the provisions of that paragraph."[941]

The OECD opted to remain true to Action 7's solutions for article 5 (5) 2017 OECDMC's wording, disregarding the stakeholders' pleas on the need to improve this provision by limiting its scope and reach, as it will result in a disproportionate

[941] OECD – *Model Tax Convention*… 2017.

measure with a far too low threshold, even more so considering that it is not focused on artificial or avoidance practices[942].

In this sense, unfortunately once more, we recall the preceding Chapters analysis and critique on the wording of the new article 5 (5) 2017 OECDMC, as they apply herein, and with the added concern of effective implementation via the OECDMC.

Nonetheless, the above transcription of this provision denotes that the OECD actually reviewed and improved it, even if in a niche area and in one that does not have an impact on this provision's major issues, specifically on the express reference to the application of the anti-fragmentation rule within the DAPE concept[943].

That express addition goes directly against one of the critiques previously made, as it was unclear whether or not the anti-fragmentation rule's cross-sectional application would also encompass the DAPE concept and article 5 (5) OECDMC, and it was our view that it should also apply herein, thus maintaining equal treatment regardless of the way the enterprise conducts its business activity in source countries, however that exact reference to avoid doubts was lacking[944].

This marks another moment of the OECD's relevant work in clarifying Action 7's solutions and in taking into consideration the stakeholders' alerts on the PE concept's improvement.

That reference clearly expands the anti-fragmentation rule's scope, rendering it significantly more effective against the artificial fragmentation of cohesive business operations for the sole goal of preventing PE status. On the other hand, it also worsens our concerns over this provision's overbearing reach, as it is not limited to artificial practices[945].

Furthermore, from this additional work, not only did this provision's interpretation and application become clearer for tax administrations and taxpayers alike, a significant issue throughout article 5 2017 OECDMC, but it also assists in lowering the DAPE concept's threshold, as enterprises can no longer claim refuge within the specific activity exemptions provision for their dependent agents'

[942] CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 12-13.
[943] CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 10-11.
[944] *Ibid*.
[945] CALABRESE, Mattia – *Chapter 5: Taxing*… p. 11.

activities that are part of a cohesive business operation by claiming that these activities have a preparatory or auxiliary character.

Thus far, a glimpse of a pattern emerges from the OECD's demeanour in the 2017 update, as it steers away from tackling the major issues identified in Action 7's solutions and opts to conduct pinpointed actions to improve minor elements of those solutions, which effectively enhance them but not to a point where their major shortcomings are surpassed.

Concluding article 5 (5) 2017 OECDMC's wording's review, aside from a noteworthy clarification to article 5 (4) 2017 OECDMC's role herein, the 2017 update replicated Action 7's solution.

On this provision's Commentary's review, disappointingly, the above conclusion is similar to the one made herein, since the 2017 update to this provision's Commentary has also mostly replicated Action 7's proposed amendments[946].

With effect, there is only one noteworthy adjustment perpetrated by the OECD to article 5 (5) 2017 OECDMC's Commentary vis-à-vis Action 7's solutions, notably to clarify a novel concept, *i.e.,* the principal role of the agent that leads to the regular conclusion of contracts by the enterprise/principal.

The 2017 update embraces and clarifies Action 7's solutions, by making clear that where the agent carries out the principal role leading to the regular conclusion of contracts without material modification by the enterprise in the Source Country, for purposes of applying article 5 (5) 2017 OECDMC, it is irrelevant that the enterprise formally concludes such contracts outside that country, meaning that in such cases the agent could still be deemed to constitute a PE for the enterprise[947].

This clarification is aligned with Action 7, as the shifting of the contracts' conclusion process was another of the MNEs' BEPS practices to artificially avoid PE status, therefore, the focus and attention now lie more with the activities performed by the agent vis-à-vis the enterprise and less on the formal aspects that orbit their relationship[948].

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[946] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 82-101.
[947] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 88; GALLO, Giulia – *Chapter 11: Active*… p. 15.
[948] *Ibid*; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 10.

Furthermore, the 2017 update adds another interpretational element on what should be understood as a material modification, a concept lacking definition and guidance, through an example, in which it refers to the contracts' key aspects, meaning that a material modification should alter those key aspects, remaining the doubt as to what should be understood as a contract's key aspects[949].

Moreover, the routinely concluded concept was also slightly densified by this example, in which the contract's conclusion included the review and approval of the same, with the review not modifying its key aspects, hence this provision's scope becomes even more enlarged, the extent of which remains unknown due to the chronic lack of guidance[950]. As usual, the OECD is scarce on guidance and explanations, leaving more doubts than certainties.

Our review of article 5 (5) 2017 OECDMC's is concluded, leaving clear that, regrettably, our preceding critique and identified problems remain accurate and valid herein, with a disproportionate provision that goes way beyond its needs to fight and prevent artificial avoidance practices and whose threshold has been set much too low, to a point that could become detrimental to business activities and the international taxation system[951].

The OECD declined to listen to the stakeholders' critique regarding this provision and its malfunctions, and in doing so missed the opportunity to salvage a potentially suitable provision. It is astonishing that the OECD made some improvements to this provision and yet dismissed the major issues that reside at its core.

Although this provision has merits, such as the ingenious method used to terminate the division and divergences between Common and Civil law countries over this provision's interpretation and application, by foreseeing both legal and economic obligations, those continue to be supplanted by its demerits[952].

Considering the OECDMC's nature and its routine reviews and improvement, we call for this provision to be substantially revised and redrafted with proper limits and guidance, since currently, it is not an adequate provision due to the nefarious

[949] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 88.
[950] *Ibid*.
[951] CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 12-13.
[952] GALLO, Giulia – *Chapter 11: Active*… p. 15; CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 10, 12-13.

spillover effects it causes, together with the remainder of its already addressed shortcomings, based on which this provision should not have been adopted by the OECDMC.

4.5.2. 2017 OECDMC vs Action 7 and the MLI

Following our review of article 5 (5) OECDMC's 2017 update, we will venture onto the similitude between the 2017 update and Action 7 and the MLI, as the primal quake and the first aftershock, respectively, to assess whether these are harmonious and coherent amongst themselves.

As noted, apart from case-specific minimum wording adjustments, the 2017 update to this provision is an almost exact replica of Action 7 and the MLI, with the praised exception of the express reference to the application of the anti-fragmentation rule within this provision, something we highlighted and that had not been addressed.

Therefore, the 2017 update deserves commendation for clarifying this element and shedding further light on this provision's interpretation and application, thus potentially reducing disputes between tax administrations and taxpayers. However, simultaneously, this update did not address any of the other issues raised and that should have been addressed, hence the OECD's improvement to Action 7's solutions in the 2017 update is rather limited and beneath the expectations.

The Commentary's 2017 update follows the same line, with it being an almost exact copy of Action 7's solutions apart from the clarifications on the irrelevance for the DAPE status of the place where contracts are routinely concluded by the enterprise without material modification, as well as some level of additional guidance as to what a material modification and routinely conclusion is, with an added example[953].

As a result, we find article 5 (5) OECDMC's 2017 update to be disappointing, as it failed to champion innovation and to enhance a provision in dire need of substantial revision. Considering that it has been implemented in the MLI and adopted by the OECDMC, the concerns raised ought to materialize across the DTT

[953] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 88.

network and hinder the international taxation system, with an overly low DAPE threshold and a disproportionate measure.

On the other hand, at least there is a harmonious match between article 12 (1) MLI and article 5 (5) 2017 OECDMC, which respects the BEPS Project's goal of a harmonious and coherent implementation of the relevant DTT-related measures. Yet, this fact brings extra concern over both provisions, as they should not have been implemented nor adopted without significant modification and additional guidance, consequently disputes ought to soar over these provision's application.

4.6. Article 5 (6) 2017 OECDMC

In this section, we focus on article 5 (6) 2017 OECDMC and the independent agent status, both with a pivotal role within the DAPE concept.

The independent agent status provides another exception to the DAPE concept, together with the specific activity exemptions, meaning that where an agent has an independent status vis-à-vis an enterprise, its actions on behalf of that enterprise shall not create a PE for the latter[954].

Historically, this provision had examples of types of agents that were deemed to be independent by definition, as long as they acted in the ordinary course of their business as agents, regardless of their relationship with the principal[955]. This was a loophole MNEs explored on their behalf to keep on carrying their business activities in source countries without triggering a PE therein, especially with group or related persons, and was another evidence of the interpretive differences between Civil and Common law countries[956].

Action 7 sought to prevent such practices from continuing to collect article 5 (6) OECDMC's benefits and proposed a complete overhaul to this provision, including the introduction of a dependence presumption of the agent vis-à-vis the principal and the elimination of certain agents' "independency by definition"[957].

[954] GALLO, Giulia – *Chapter 11: Active*… p. 16.
[955] CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 10-11.
[956] CALABRESE, Mattia – *Chapter 5: Taxing*… p. 11.
[957] CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 10-11.

Through these modifications, MNEs' schemes would be invalidated, since this presumption specifically targets agents that are closely connected to their principal and act in almost exclusivity on the latter's behalf, stripping them of the independent agent status' benefits and submitting them to article 5 (5) OECDMC's tests[958].

However, Action 7's solutions are imperfect, especially on the lack of guidance and support for the paths followed and the absence of limits to its subjectivity.

In this context, it matters to assess whether the 2017 update to article 5 (6) OECDMC embraced Action 7's solutions and whether it enhanced them by removing the issues identified.

4.6.1. The update

Proceeding with the 2017 update to the independent agent status, as seen, article 5 (6) OECDMC has a pivotal role in the DAPE concept, especially considering that we find that this concept's interpretation should commence with the assessment of this provision, as the first test of the DAPE status.

Following our course of action for reviewing the 2017 OECDMC's PE concept, we begin with this provision's wording:

> "*6. Paragraph 5 shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.*"[959]

Remarkably, article 5 (6) 2017 OECDMC's stands as a twin of Action 7's solutions, at least in part, since the OECDMC split Action 7's proposed measures into two separate provisions, the one dealing with the independent agent status was kept in its rightful place in article 5 (6) OECDMC, and the novel concept of "person or

[958] GALLO, Giulia – *Chapter 11: Active*… p. 16; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 11; MONSENEGO, Jérôme – *The Independent Agent*… pp. 951, 954.
[959] OECD – *Model Tax Convention*… 2017.

enterprise closely related to an enterprise" has been moved to a separate provision within article 5 OECDMC, namely article 5 (8) 2017 OECDMC.

We support the splitting of these concepts into separate provisions, as they have distinct purposes and objectives within this article that should not become mixed, consequently, this separation enhances both provisions' legal certainty and clarity, especially when considering article 5 (8) 2017 OECDMC's relevance across this article and the particularities of the independent agent status.

As such, our previous analysis on Action 7's proposed measures to this provision, notably on paragraph (a), continues valid and applicable herein, in the absence of any modification.

With the wording review finalized, we advance to this provision's Commentary's 2017 update, where the pattern identified thus far regarding the OECD's action continues, meaning that few and localized changes have been conducted[960].

A careful analysis of article 5 (6) 2017 OECDMC's Commentary reveals that the OECD truly embraced Action 7's solutions and transposed them to the OECDMC, regrettably with very limited improvement, and when such improvement exists it tends to deviate from the prejudicial elements and concentrate on parallel aspects, even if still of some relevance[961]. With effect, the OECD made only one variation to Action 7's solutions on this provision's Commentary[962].

The OECD emphasizes that activities carried out by an independent agent that are unrelated to its agency business cannot be said to be carried out in the ordinary course of its business as an agent, reinforcing the paradigm shift proposed by Action 7 that the relevant element to consider for the ordinary course test lies with the agent's agency activities and business[963].

This clarification sustains that this criterion orbits around the agency business and that unrelated activities are outside this business's ordinary course, which targets this test's different interpretations, which relied on the previous less

[960] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 102-114.
[961] *Ibid*.
[962] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 110.
[963] *Ibid*; GARBARINO, Carlo – *Permanent Establishments and*… pp. 378-379.

accurate wording, as commented, hence preventing disputes and increasing legal certainty, which should be praised[964].

The OECD also streamlined the example depicting that unrelated activities shall not be considered when applying this provision, for instance on the dependence presumption, where a company acts for several companies as a distributor on its own account and, at the same time, it acts as an agent for another enterprise, the distributor activities that that company carries out are irrelevant when assessing the ordinary course of its business, as this relates to agency business[965].

Furthermore, the OECD did not limit itself to the mere clarification and streamlining of Action 7's solutions, it went beyond it and added an element to the ordinary course test, together with an example[966].

In this sense, albeit activities unrelated to the agency business undertaken by an independent agent shall not be considered as part of the ordinary course of its business, this may not apply to intermediation activities that under a particular business sector's common practice an enterprise carries out sometimes as an agent and sometimes at its own account, meaning that these intermediation activities may be considered to be part of the agent's ordinary course of business, provided that these intermediation activities are comparable and, in substance, indistinguishable from each other[967].

For instance, it occurs with a broker-dealer in the financial sector performing marketing intermediation activities, sometimes as an agent and others at its own account, but all in the same way and aligned with the clients' needs, thus these various intermediation activities shall still be in the ordinary course of its agency business[968].

This clarification was meant to reduce disputes and divergences over this provision's interpretation and application, especially in those sectors where it is common practice for a person to be shifting from acting as an agent and for its own account without any material modification to the activities actually performed vis-

[964] *Ibid*; CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 9-11.
[965] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 110; GARBARINO, Carlo – *Permanent Establishments and*… pp. 378-379.
[966] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 110.
[967] *Ibid*; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 11.
[968] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 110.

à-vis its clients, however, given the subjective approach taken, it may, in fact, lead to greater disputes and divergences over what is deemed to be the ordinary course, potentially second-guessing the clarification of this test's focus on the agency business and less on sector specifics[969].

The doubt this clarification could cast over interpreters should have been avoided, as this element was reviewed in the 2017 update and the OECD should work consciously and coherently with the stances it adopts to prevent further disputes and divergent interpretations[970].

This clarification comes as a pleasant anticyclical measure on the 2017 update's relationship with Action 7, as it widens the scope of the independent agent status, thus slightly lifting the DAPE threshold, which is highly welcomed considering the prejudicial effects of article 5 (5) 2017 OECDMC on it.

In any case, apart from these lesser remarks, the previous analysis and critique regarding this provision are still accurate and valid herein, as such, for the sake of brevity, we refer to our previous remarks, as very little was made on the shocking lack of guidance for a provision that was significantly modified and there is no substance to support the guidance on the application of the dependence presumption and its 10% threshold[971].

Similar to the previously reviewed provision, it is disconcerting that the OECD found the need to elaborate and provide additional guidance on the ordinary course test, certainly taking into account the concerns raised by stakeholders on this somewhat stable element, and, at the same time, failed to understand the urgency for additional guidance to this overhauled provision, also called for by stakeholders[972].

The OECD's role herein should have been bolder and more coherent, meaning that the improvements to the DAPE concept should have been extensive and detailed and not limited to minor adjustments or additions. If it intended to improve and strengthen this concept, then it should have done it in its entirety, which includes reviewing Action 7's solutions, especially its lack of guidance.

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969 CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 9-11.
970 CALABRESE, Mattia – *Chapter 5: Taxing*… p. 11.
971 *Ibid*; GALLO, Giulia – *Chapter 11: Active*… p. 16.
972 KOSTIC, Svetislav V. – *Chapter 3: New*… p. 8.

4.6.2. 2017 OECDMC vs Action 7 and the MLI

The review of article 5 (6) OECDMC's 2017 update has revealed that this new provision's most relevant difference vis-à-vis its Action 7 blueprint lies not on what it includes but on what it is lacking, *i.e.*, the closely related concept, thus it matters to compare it to Action 7 and the MLI.

The MLI and the 2017 OECDMC seek a common goal on the DAPE concept, to implement Action 7's solutions across the DTT network through a two-pronged strategy of amending previous DTTs and shaping new DTTs[973].

In this context, our review made clear that article 5 (6) 2017 OECDMC is aligned with Action 7's proposed measure's wording on the independent agent status, and, consequently, with article 12 (2) MLI, as the MLI also follows Action 7's wording. In fact, there is an almost harmonious relation between the 2017 OECDMC and the MLI herein, marking a significant step forward on the coherent and synchronised implementation of Action 7.

Although both instruments' provisions are closely aligned, we find article 5 (6) 2017 OECDMC to be an enhanced provision vis-à-vis article 12 (2) MLI, due to the amendments perpetrated in the former's Commentary, which broadened the scope of the agent's actions that may fall within the ordinary course test by looking through the legal form that shrouds such actions and taking into account the context where those comparable and undistinguishable actions are undertaken[974].

Yet, this is another subjective element added to the PE concept, affecting legal certainty and fostering legal disputes if not properly delimited[975].

Despite the merits of the 2017 OECDMC and the MLI's alignment, proving the OECD's efforts for a combined implementation front, such alignment comes as a concern due to the OECD's inaction to properly improve article 5 (6) 2017 OECDMC by adding the necessary guidance to optimize and prepare this provision for broad implementation throughout the DTT network, meaning that the DTT network will

[973] GALLO, Giulia – *Chapter 11: Active*… pp. 16-17.
[974] CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 10-11.
[975] CALABRESE, Mattia – *Chapter 5: Taxing*… p. 11.

be affected by an unsatisfactory independent agent status provision that could lead to further disputes, divergent interpretations and loopholes for MNEs to explore[976].

Nevertheless, we maintain our comments and general support to this provision, which, with proper guidance, has the capability to effectively fight and prevent the artificial avoidance of PE status and nullify schemes using related persons to carry out the principal's business activities, thus recovering the historic purpose of the independent agent status as the *bonafide* agent.

Unfortunately, this provision's success is overthrown by its umbilical relation to article 5 (5) 2017 OECDMC and the nefarious effects to the DAPE concept emanating from it.

As a concluding remark on the OECDMC's 2017 update to the DAPE concept, the minimum level of additional work and extensive mindless copying of Action 7's solutions is profoundly unsatisfactory, especially because this concept was in the BEPS Project's crosshairs and, since Action 7's inception, interested stakeholders have continuously analysed and critiqued its solutions so that these could be revised before implementation due to the nefarious side-effects, offering multiple alternatives.

4.7. Article 5 (7) 2017 OECDMC

At this stage, we have completed the review of article 5 OECDMC's provisions that were overhauled in the 2017 update as per Action 7's work, remaining only two provisions to review, one that was left unscathed and one that is a completely new addition.

Focusing on the provision that was left unscathed by the OECDMC's 2017 update, article 5 (7) OECDMC, which encompasses the principle of separate entity approach, or, in other words, that the mere fact that an enterprise is wholly-owned by another enterprise from another country does not mean that either one is a PE of the other, *i.e.*, the relevant PE concept's tests still need to be surpassed[977].

[976] GALLO, Giulia – *Chapter 11: Active*… p. 16.
[977] GALLO, Giulia – *Chapter 11: Active*… p. 17.

The OECDMC's 2017 update did not make any noteworthy amendment or clarification to this provision, just minor simplifications[978]. Therefore, we refer to the comments on Chapter 1 regarding this provision and advance onto the final provision of article 5 2017 OECDMC.

4.8. Article 5 (8) 2017 OECDMC

Lastly, we review one of the most important provisions of the PE concept, article 5 (8) 2017 OECDMC and the concept of closely related to an enterprise, freshly introduced by the 2017 update.

As noted, this concept has cross-sectional relevance within article 5 2017 OECDMC, being a vital element of the provisions that bear an anti-abusive nature to prevent closely related persons, including individuals and enterprises, from taking advantage of their relationships to distort the PE concept's benefits and tilt the global economy and international taxation system's playing field.

This measure, like article 5 (6) 2017 OECDMC, dons a sharp presumption, in this case on the qualification of a person as being closely related to an enterprise based on control[979].

We support this provision due to its suitability to achieve its goal, providing relevant support for this article's remaining provisions with a well-designed presumption, while at the same time providing some flexibility by eluding to a facts and circumstances approach, even if this subjectivity's boundaries are not properly established[980].

Therefore, it matters to ascertain how this provision was implanted in the OECDMC, *i.e.*, whether there was additional work on it or simple copy-paste action.

[978] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 116.
[979] GILLESPIE, John – *The Base Erosion*… pp. 30-31.
[980] GILLESPIE, John – *The Base Erosion*… p. 48.

4.8.1. The new provision

The transposition of article 5 (8) 2017 OECDMC, or the closely related provision, partially broke from the OECDMC's 2017 update's pattern of replicating Action 7.

With effect, the OECD took Action 7's solution and granted it the dignity and relevance such a provision demands, by making it a separate provision within article 5 2017 OECDMC, rather than being grafted onto article 5 (6) OECDMC:

"*8. For the purposes of this Article, a person or enterprise is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person or enterprise shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person or enterprise possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise or in the two enterprises.*"[981]

As mentioned, we supported the separation of this provision from the independent agent provision, considering its transversal effects and sheer importance in this article, otherwise, it could potentially lead to doubts as to its interpretation and application[982].

Considering Action 7's solution and article 5 (8) 2017 OECDMC, it becomes clear that the OECD's work on the transposition was very limited, both in this provision's wording and Commentary.

Concretely, the OECD's work on this provision's wording is reduced to an unnecessary clarification that it also applies to multiple enterprises and the relationships between them. However, article 3 (1) OECDMC already states that "person" is a fairly broad concept, hence such concept together with the rest of

[981] OECD – *Model Tax Convention*… 2017.
[982] GALLO, Giulia – *Chapter 11: Active*… p. 18.

article 5 (8) 2017 OECDMC's wording, already made clear that this provision would apply to a two enterprises scenario.

The OECD took the same stance in the Commentary, by clarifying this provision's application to a multiple enterprises scenario[983]. It also included a minor clarification to the closely related presumption, under which this provision's requirements for being closely related are automatically met, making clear that the focus lies on the requirements[984].

The OECD followed its working pattern of limited and surgical clarifications, as opposed to more relevant revisions and additional guidance. Since article 5 (8) 2017 OECDMC is closely aligned with Action 7's solution, we refer to our previous comments and analysis.

With this provision's review complete, we will evaluate it vis-à-vis Action 7 and the MLI, on whether it is a cause for a unified implementation front or divergent country practices.

4.8.2. 2017 OECDMC vs Action 7 and the MLI

As noted, article 5 (8) 2017 OECDMC is mostly a twin of Action 7's solution, having graduated to a detached provision within article 5 2017 OECDMC, instead of a paragraph in article 5 (6) OECDMC.

The OECDMC and the MLI are aligned on the closely related provision, with article 5 (8) 2017 OECDMC matching article 15 MLI, both are standalone provisions with an identical application. Yet, in our view, article 5 (8) 2017 OECDMC still trumps article 15 MLI over the latter's regrettable optional nature.

Furthermore, both provisions implemented, mostly unchanged, Action 7's solution, which collected praise from stakeholders as an important measure to improve and strengthen the international taxation system.

It is expectable that this provision's implementation across the DTT network will stay close to the BEPS Project's goal for a swift and coherent implementation, depending on the countries options under the MLI.

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983 OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 119, 121.
984 OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 121.

In this sense, following our general critique, this provision's swift and harmonious implementation would greatly benefit from additional guidance on its novel concepts, the boundaries of its subjective approach, the closely related presumption and the distinction between this provision and article 9 2017 OECDMC.

The OECD's demeanour in this provision is substandard, the OECD's work was expected to go beyond Action 7 and the MLI and not be reduced to lesser tweaks and semantics, to continue to be a paladin for the international taxation system at the vanguard of the international taxation's innovation and prevention of artificial avoidance, instead of an execution body.

The review of article 5 (8) 2017 OECDMC is complete and, as such, also of article 5 2017 OECDMC as a whole, having addressed the PE concept's novel elements as well as the ones subject to an overhaul, some more extensively and others more pinpointed, but all with its particularities and a wide room for improvement.

4.9. 2017 OECDMC vs Action 7 and the MLI – Overview

At the end of the OECDMC's 2017 update's review, it is relevant to weigh the work of this second aftershock to Action 7's initial quake on the PE concept, which has crystallized a new standard for it, generally aligned with the MLI as the first aftershock.

As noted, the bulk of the OECDMC's amendments and clarifications originated from Action 7's work, in the same sense as part IV of the MLI derives from it, and less from the proper revision of article 5 OECDMC as a whole, with the most noteworthy adjustment unrelated with Action 7 being the clarification on the "at the disposal" element in article 5 (1) 2017 OECDMC[985].

Article 5 2014 OECDMC had aspects that needed renovation and improvement, but Action 7 only addressed part of them, with the remaining being left out of this recent update, absent of proper reason. Due to the OECD's inaction, the critiques and concerns raised in this thesis on some of these aspects remain valid.

[985] GALLO, Giulia – *Chapter 11: Active*… pp. 4-5.

Since its inception, it was established that the existing pillars and standards were not to be altered by the BEPS Project's work on the PE concept, instead, these were supposed to be enhanced.

However, the OECDMC's 2017 update was not under the same shackles as Action 7, therefore the OECD could have taken Action 7's work and build upon it to effectively improve the PE concept, perhaps even adjusting its standards.

Furthermore, our review presents a stream of criticism to the OECD's work, which in this case refers to its lack of additional work on Action 7's solutions together with the missed opportunity to tackle the PE concept's pre-existing issues and upgrade it for the global economy and the international taxation system's current stage.

Time-wise, this less ideal and quicker update could denote a future dynamic approach to the OECDMC's revision, with more frequent modifications to prevent existing concepts from being rendered useless due to technological and economic progress, as it happened with the PE concept[986]. Yet, four years have elapsed since this update and a revision has yet to rise on the horizon.

Our overview of the OECDMC's 2017 update reveals that it complied with the adoption of Action 7's solutions and that it is mostly aligned with the MLI, thus, in this regard, it should be acknowledged as a success and a step forward in the fulfilment of the BEPS Project's objectives[987].

However, the proximity between the OECDMC and the MLI means that on the PE concept's actual improvement, the OECDMC's 2017 update is less successful, as it suffers from the same ails as Action 7 and the MLI, resulting in a batch of imperfect provisions producing a substantially low PE threshold that, although capable of preventing the artificial avoidance of PE status, go needlessly beyond it[988].

Still, the OECDMC's work that went beyond Action 7's framework, particularly in article 5 (1) 2017 OECDMC, is welcomed and commendable, being scarceness its only downside[989].

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[986] GILLESPIE, John – *The Base Erosion*… p. 52.
[987] GILLESPIE, John – *The Base Erosion*… p. 25.
[988] GILLESPIE, John – *The Base Erosion*… pp. 52, 54.
[989] GILLESPIE, John – *The Base Erosion*… p. 25.

4.9.1. 2017 OECDMC – Reservations

While under this overview, the contrast between the countries' reservations and options in the 2017 OECDMC and the MLI is noteworthy.

The substantially different legal weight both instruments have, the OECDMC as soft law and general guidance for countries to negotiate bilateral DTTs and the MLI as a binding international convention partly justifies this contrast[990].

As noted, the MLI's part IV's implementation rate is roughly 50%, with many countries opting to reserve their right not to implement some, or all, of part IV articles. However, countries have not adopted the same behaviour in the 2017 OECDMC, instead, reservations are quite scarce, even among countries that exercised their reservation rights in the MLI's part IV[991].

For instance, the USA did not sign the MLI and reserved their right to apply article 5 (5) and (6) 2014 OECDMC, thus rejecting this provisions' 2017 update, however, the USA did not take the same stance on this article's remaining provisions[992].

With effect, article 5 (5) and (6) 2017 OECDMC collect most of this article's reservations, with countries preferring to apply the 2014 version, such as Finland, Germany, Sweden, Switzerland, Luxembourg, and Singapore[993].

Furthermore, only Finland and Sweden have chosen to opt-out of the OECDMC's 2017 update entirely, by reserving their right to apply article 5 (5) and (6) 2014 OECDMC and to not include article 5 (4) (1) and (8) 2017 OECDMC, reinforced with an observation on the Commentary to article 5 (4) 2017 OECDMC to exclude the

990 GILLESPIE, John – *The Base Erosion*… pp. 24-25.
991 OECD – *Model Tax Convention*… 2017. Reservations on article 5 para. 187-216; OECD – *Model Tax Convention*… 2017. Positions on article 5; GILLESPIE, John – *The Base Erosion*… pp. 37-38; HATTINGH, Johann – *The Impact of*… pp. 240, 242.
992 OECD – *Model Tax Convention*… 2017. Reservations on article 5 para. 187; PISTONE, Pasquale – *Chapter 1: General*… p. 10.
993 OECD – *Model Tax Convention*… 2017. Reservations on article 5 para. 213-215; OECD – *Model Tax Convention*… 2017. Positions on article 5 para. 17.3, 19.2.

anti-fragmentation rule[994]. Luxembourg and Switzerland have also reserved their right not to include article 5 (4) (1) 2017 OECDMC[995].

The above options denounce the coherence of a few countries and the lack thereof of many others, for instance, Finland and Sweden stayed true to their options on the MLI and replicated them on the OECDMC, however, the vast majority of countries that reserved their rights not to apply part, or all, of the MLI's part IV, have not done the same in the OECDMC[996].

Such a noteworthy disparity will lead to divergent country practices within the PE concept, resulting in a heterogeneous DTT network and a likely surge in disputes between tax administrations and taxpayers, which lies opposite to the BEPS Project's goals[997].

This contrast also indicates that, despite the countries surprising support and adherence to the MLI, they still privilege bilateral negotiations and prefer to renegotiate each DTT in the traditional way, making the show of support to a multilateral effort in international taxation more a political statement than a true paradigm shift[998].

Lastly, this contrast could also mean that Action 7's implementation across the DTT network will not be as scarce as the MLI appeared to signal, considering that very few countries made reservations on the 2017 OECDMC's PE provisions and that its modifications vis-à-vis Action 7 are not substantial.

4.10. Preliminary conclusions

Having presented and reviewed article 5 2017 OECDMC, some conclusions can be drawn from this Chapter, where we highlighted the aspects revised vis-à-vis

[994] OECD – *Model Tax Convention*… 2017. Reservations on article 5 para. 212-216; OECD – *Model Tax Convention*… 2017. Observations on the Commentary on article 5 para. 184.
[995] OECD – *Model Tax Convention*… 2017. Reservations on article 5 para. 212.
[996] OECD – *Model Tax Convention*… 2017. Reservations on article 5 para. 187-216; OECD – *Model Tax Convention*… 2017. Positions on article 5; OECD – *Signatories and Parties*…
[997] SAINT-AMANS, Pascal; RUSSO, Raffaele – *The BEPS Package*… p. 241.
[998] GILLESPIE, John – *The Base Erosion*… p. 38.

Action 7 and referred to previous Chapters' work where the 2017 update failed to introduce relevant change.

The OECDMC's relevance throughout the international taxation system is unquestionable, therefore its update as per the BEPS Project's deliverables was a natural consequence to strengthen the efforts to implement the BEPS Project's DTT-related measures swiftly and coherently across the DTT network, and to fortify the PE concept to prevent the artificial avoidance of PE status, both initiated with the MLI.

For the BEPS Project's sake and that of its objectives, the OECDMC's 2017 update and the MLI needed to be aligned.

Also, the OECD took the opportunity offered by this update to review and improve some of the PE aspects that required attention and that were not under Action 7's spotlight, although timidly, such as on article 5 (1) 2017 OECDMC and the "at the disposal" element.

The work conducted on the aforementioned element deserves praise for its success in clarifying a vital element of the physical and project PE concepts, one that is likely to reduce divergent interpretations and disputes, and to increase legal certainty, often lacking in this article.

Despite this improvement, the OECD still refrained from tackling the challenges identified in Chapter 1 or taking a bolder action and introduce an objective minimum time threshold, alongside the already existing anti-abuse measures.

Differently, the lack of additional guidance on most of the provisions targeted by Action 7 is striking, particularly since the OECDMC is the prime location to clarify and supply interpreters with the necessary guidance for novel elements and provisions, and yet little was made on this matter. More than the mere replication of Action 7 and the MLI was required from the OECD.

Nonetheless, as the OECDMC is an open instrument with continuous updates, we call for the OECD to address the stakeholders' concerns and revise the OECDMC's provisions accordingly, some requiring additional guidance and others substantial redrafting and awareness over the spillover effects, such as article 5 (4) (1), (5) and (6) 2017 OECDMC.

These provisions should continue to be improved within the OECD's regular and ongoing work, with their application carefully monitored to identify and amend their adverse spillover effects, which have not been dealt with thus far.

Our critique on the OECD's general inaction in the OECDMC's 2017 update to the PE concept, does not spoil the merits and praise that some of the solutions deserve, even if imperfect, such as the anti-splitting rule or article 5 (8) 2017 OECDMC.

The imperfectness of article 5 2017 OECDMC could be the reason some countries are taking unilateral action with strong anti-abuse measures, such as the UK's diverted profit tax or Australia's multinational anti-avoidance law, contrary to the BEPS Project's purpose.

The OECD's lack of proper and detailed work on this update leads us to question if its actual purpose was to effectively improve and remedy the PE concept to better equip it for the current global economy and against artificial avoidance practices, including addressing pre-existing concerns, or to merely transpose Action 7's solutions without critically assessing them and their effect, and abstaining from amending pre-existing issues.

The 2017 update dons a blunt disregard for the concerns raised by stakeholders over the side-effects and spillovers arising from Action 7's solutions, remaining the mystery whether the OECD valued these solutions in anything more than their mere conceptual value, absent of notion of practical implications upon implementation.

Furthermore, the OECD's work should not have been mostly limited to transplanting Action 7 to the OECDMC, the efforts and objectives of achieving a swift and coherent implementation of the BEPS Project's DTT-related measures should not be pursued at the expenses of hindering the PE concept, especially giving the stakeholders' general consensus that Action 7's solutions require additional work.

Our work reveals that this thesis' earthshattering analogies are quite accurate, considering that Action 7 effectively shook the PE concept by proposing significant changes to remedy this concept's limitations on artificial avoidance and that the MLI and the 2017 OECDMC closely followed that initial tremor by replicating its remedies, with little to no change, within themselves in subsequent events.

However, countries acted differently following each of the subsequent shocks, in the MLI *circa* 50% of the signatories reserved their right not to apply part, or all,

of part IV articles, while in the 2017 OECDMC the vast majority of countries have not done so, with the DAPE concept's provisions standing out has the ones least welcomed.

The contrast between the MLI and the 2017 OECDMC implies a greater commitment to the novel PE provisions than initially expected, based solely on the MLI, but also suggests that countries prefer bilateral renegotiations of DTTs rather than the MLI's multilateralism-ish method, which is the exact opposite of the BEPS Project's objectives. Therefore, considering the cumbersome process of bilaterally renegotiating DTTs, these PE measures' swift implementation is in peril, consequently, divergent country practices will surely rise, as will the opportunities for MNEs to continue executing BEPS strategies and explore new ones.

The conclusion of this Chapter marks the end of our analysis of the BEPS Project's main aftershocks. Moving forward, our thesis will focus on these quakes' impact within Portugal and its DTT network.

CHAPTER 5 – THE PORTUGUESE PERMANENT ESTABLISHMENT CONCEPT – A Procrastinated and Enigmatic Tremble

The PE concept is of the utmost importance when allocating taxing rights over income between two countries that share a nexus with it[999], serving as the cornerstone between the source principle and the residence principle[1000].

Yet, this concept still requires adequate means to effectively regulate the countries' taxing intentions within the international taxation system, namely by providing it with the necessary legal force, *i.e.*, through a DTT.

A DTT shrouds the PE concept, and all other concepts enshrined in the OECDMC, with the legal effect needed to achieve their purpose, be it on the allocation of taxing rights or the elimination of double taxation, thus transitioning from soft law to hard law[1001]. The OECDMC provides countries with a DTT structure and a draft of its content, the articles, together with elements relevant for its interpretation, the Commentary.

As noted, each country is free to enter into a DTT in the way that best fits its national interests, subject to negotiation based on the bilateral relations between the relevant countries[1002]. Therefore, each country may steer its DTTs closer to the OECDMC or deviate from it, based on the countries' agreement to enter into a DTT.

Also, countries often use the OECDMC to display their positioning on a particular aspect, through reservations and observations to the OECDMC's articles, serving as an advance notice to DTT negotiations.

Portugal, a sovereign country, enjoys the same taxation privileges as other countries, as independence over its right to tax and the ability to limit it. In fact, Portugal has willingly limited its right to tax in various ways in recent times, *e.g.* negotiating and concluding DTTs, the EU membership and the MLI's ratification.

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[999] DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty,* Tax… p. 296.
[1000] DOURADO, Ana Paula – *In Search of an International Tax System in a Post-BEPS Tax Competition Setting*. Intertax. Volume 47, issue 1 (2019) pp. 2-3; PEREIRA, Paula Rosado – *O papel do*… pp. 573-576; EISENBEISS, Justus – *BEPS Action* 7… p. 481.
[1001] This transition can be adjusted according to the countries' negotiations and agreement to share taxing rights.
[1002] KLEIST, David – *The Multilateral Convention*… p. 34.

Therefore, the analysis of Portugal's taxation system must consider its membership in international organizations and their context, for instance as a member of the EU and the OECD[1003].

Focusing on this thesis' scope, Portugal has a respectable network of concluded DTTs[1004], with the oldest dating from 1969[1005] and the newest from 2019[1006].

Portugal's view of DTTs and the OECDMC has evolved throughout its history and by 1999, as a result of the International Taxation Reform Commission, Portugal shifted its policy on DTTs and its position vis-à-vis the OECDMC[1007]. Portugal had transitioned from a mostly capital importing economy to a small open and gradually capital-exporting economy, and consequently, the OECDMC was deemed suitable for Portugal's interests on taxation, which contrasts with its past stance of attempting to enforce the reservations it had made therein[1008].

Ever since, Portugal has generally maintained the same view, negotiating each DTT on a case-by-case basis and adapting the OECDMC's concepts to its interests and relations with other countries.

Portugal's stance on the PE concept is aligned with its general view on DTTs and the OECDMC, generally following the latter's concept and occasionally deviating from it, mostly by embracing the reservations made therein.

[1003] DOURADO, Ana Paula – *Portugal* In *Assessing BEPS: origins, standards and responses*. IFA Cahiers de Droits Fiscal International. Volume 102a, 2017. Books IBFD. p. 647; REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel* on… pp. 333-334; EISENBEISS, Justus – *BEPS Action 7…* p. 481; NABAIS, José Casalta – *Direito Fiscal*. 7th edition. Coimbra: Almedina, 2012. p. 463; DOURADO, Ana Paula – *Direito Fiscal*… p. 39.

[1004] As of September, 2021, Portugal has a network of 81 DTTs, of which 77 are in force. PORTUGUESE TAX AUTHORITY – *Portuguese DTTs' Summary Table*. Available at: https://info.portaldasfinancas.gov.pt/pt/informacao_fiscal/convencoes_evitar_dupla_tributacao/convencoes_tabelas_doclib/Documents/Tabela_CDT_2020.pdf

[1005] The Portugal-UK DTT. PORTUGUESE TAX AUTHORITY – *List of Portuguese DTTs*. Available at: https://info.portaldasfinancas.gov.pt/pt/informacao_fiscal/convencoes_evitar_dupla_tributacao/convencoes_tabelas_doclib/pages/english-version.aspx

[1006] The Portugal-Angola DTT. PORTUGUESE TAX AUTHORITY – *List of Portuguese*…

[1007] XAVIER, Alberto – *Direito Tributário Internacional*… p. 111; SANCHES, J. L. Saldanha – *Manual de Direito*…. p. 357; VASQUES, Sérgio – *Manual de Direito…* pp. 101-102; COURINHA, Gustavo Lopes – *Estudos de Direito*…. p. 8.

[1008] XAVIER, Alberto – *Direito Tributário Internacional*… p. 112; DOURADO, Ana Paula – *Portugal* In *Assessing BEPS*… p. 650; VASQUES, Sérgio – *Manual de Direito…* pp. 101-102.

5.1. The Portuguese PE concept

Herein, we will examine the Portuguese PE concept, as per the Portuguese DTT network, and the effects the BEPS Project's quake and its aftershocks may have had on it, considering Portugal's stance, as well as briefly analyse the Portuguese domestic PE concept.

5.1.1. In the Portuguese DTT network

At this point, we recall our comments on article 5 2014 OECDMC, as the Portuguese DTTs' PE provisions are generally aligned with those of the 2014 OECDMC, with some exceptions among the older DTTs which are closer to older OECDMC versions, such as the 1963 draft version or the 1977 version[1009]. As such, our analysis will not replicate previous comments, instead, it will present the situations where the Portuguese PE concept deviates from that of the OECDMC.

In this sense, we highlight that Portugal made two reservations to article 5 OECDMC, both on the project PE concept[1010].

The first reservation intends to reduce the project PE's time threshold from 12 to 6 months, while the second one aims at including in its scope an enterprise that carries on an activity consisting of planning, supervising, consulting, any auxiliary work or any other activity in connection with a building site or construction or installation project lasting more than 6 months, if such activities or work also last more than six months[1011].

Despite these reservations and Portugal's past DTT policy, our analysis reveals that most of its DTTs do not follow them, actually, only 32 DTTs have a project PE with a 6-month threshold[1012], and only 1 DTT has a provision that completely replicates the reservation on project PE-related services[10131014].

[1009] TEIXEIRA, Manuela Duro – *Portugal – Permanent Establishments*. Country Tax Guides. IBFD. 2021. Accessed April 19th, 2021.
[1010] Not including Portugal's position on the Commentary on electronic commerce.
[1011] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 201, 208.
[1012] With 15 others having a 9-month threshold.
[1013] Portugal has 36 DTTs that include a partial version of its project PE-related services reservation, and of those only 18 DTTs bear the 6-month threshold for such services.
[1014] PORTUGUESE TAX AUTHORITY – *List of Portuguese*…

As commented, this evident disparity can be partly explained by Portugal's policy shift vis-à-vis the OECDMC. Also, it is useful to recall that DTTs result from an agreement between two parties based on a multitude of factors, including their bilateral relations and economic interest, as such the absence of more DTTs bearing Portugal's reservations might not be entirely linked with its inability to secure them therein.

Furthermore, it is interesting to note that although the Portuguese DTTs' PE concept is generally consistent with the 2014 OECDMC, there are still minor deviations from it in some DTTs, mostly connected with the positions from the relevant counterpart since no clear pattern is identifiable[1015].

In this context, we also underline that within the Portuguese DTT network there is already a DTT that is at the PE concept's vanguard. The Portugal-Angola DTT is the newest DTT to have been negotiated and entered into force in Portugal[1016], after Action 7 and the MLI, and its PE concept is mostly aligned with the 2017 OECDMC, with some vestiges from the UNMC[1017].

This DTT may provide a glimpse to the Portuguese DTTs' future, in a path that is closer to the 2017 OECDMC's PE concept, which had not yet happened.

The Portugal-Angola DTT does not include an express reference to the project PE concept's anti-splitting provision, and it does not include the new specific activity exemptions provision[1018]. Still, it bears the anti-fragmentation rule, the new DAPE and closely related concepts[1019].

This DTT's PE concept stands as a concoction of provisions from article 5 OECDMC's 2014 version and 2017 update, absent of support from the official Portuguese position on this article in the 2017 OECDMC, where no reservations or observations were made[1020]. Also, there are deviations between this DTT and Portugal's position on the MLI.

[1015] In this regard, we refer to, and follow, Manuela Duro Teixeira's exhaustive work on: TEIXEIRA, Manuela Duro – *Portugal – Permanent Establishments*. Country Tax Guides. IBFD. 2021.
[1016] Closely followed by the Portugal-Kenya DTT, which although ratified a year later, was signed two months before and is not yet in force.
[1017] TEIXEIRA, Manuela Duro – *Portugal – Permanent Establishments*…; PORTUGUESE TAX AUTHORITY – *List of Portuguese*…
[1018] PORTUGUESE TAX AUTHORITY – *List of Portuguese*…
[1019] *Ibid*.
[1020] OECD – *Model Tax Convention*… 2017.

Thus far, Portugal has not been actively implementing Action 7's solutions in its DTT network, and the one that is most aligned with it has only partially implemented them, thus hindering the BEPS Project's objectives for consistent and harmonious implementation of its solutions and the prevention of the artificial avoidance of PE status.

Portugal's action in this regard, or lack thereof, ought to also be analysed considering its EU and OECD membership, making it even more striking, considering the support that the prevention of the artificial avoidance of PE status received from both organizations.

5.1.2. In the Portuguese domestic law

Moving forward, we will briefly address the recently amended domestic PE concept, foreseen in article 5 of the Portuguese Corporate Income Tax Code[1021], where we shall focus on its particularities vis-à-vis the OECDMC.

Prior to the 2021 Portuguese State Budget[1022], similar to most of the Portuguese DTTs' PE concept, the domestic PE concept was closely aligned with that of article 5 2014 OECDMC, with minor deviations from it[1023].

The domestic PE concept had remained unchanged since January 2001 (until 2021), when a substantial reform took place and aligned this concept with that of article 5 OECDMC, whose wording had also remained mostly unchanged from 1977 until the 2017 update[1024]. Before addressing the 2021 reform of the domestic PE concept, it matters to address the existing and unchanged elements of the domestic PE concept vis-à-vis the OECDMC.

[1021] PORTUGUESE CORPORATE INCOME TAX CODE – Implemented by Decree-Law no 442-B/1988, of 30 November (as amended) [Código do Imposto sobre o Rendimento das Pessoas Coletivas].
[1022] 2021 PORTUGUESE STATE BUDGET – Law no. 75-B/2020, of 31 December.
[1023] TEIXEIRA, Manuela Duro – *Portugal – Permanent Establishments*…; TEIXEIRA, Manuela Duro – *A Determinação do Lucro Tributável dos Estabelecimentos Estáveis de Não Residentes*. Coimbra: Almedina, 2007. p. 23; XAVIER, Alberto – *Direito Tributário Internacional*… pp. 311-322; SANCHES, J. L. Saldanha – *Manual de Direito…* p. 357.
[1024] TEIXEIRA, Manuela Duro – *Portugal – Permanent Establishments*…; XAVIER, Alberto – *Direito Tributário Internacional*… p. 311; GALLO, Giulia – *Chapter 11: Active*… p. 4; SANCHES, J. L. Saldanha – *Manual de Direito…*. p. 357.

Although similar, the domestic PE is defined as a fixed installation through which an activity of commercial, industrial or agricultural nature is carried on, which broadly refers to business activities[1025].

The most noteworthy differences between the domestic PE and that of the OECDMC emerge from Portugal's reservations in the OECDMC, namely the 6-month threshold for project PEs and the project PE-related services[1026].

There also other minor deviations from article 5 2014 OECDMC's wording, but these are mostly express references to situations and concepts already foreseen in this article's Commentary, such as the express mention to effectively bearing the activity's risk for the independent agent status or to the time computation of the project PE time threshold and the subcontractor provision[1027].

Fast-forwarding to 2021, article 373 of the 2021 Portuguese State Budget introduced a comprehensive reform to the domestic PE concept, partially amending it since it was a leading cause of BEPS, like article 5 2014 OECDMC, thus embracing and implementing Action 7's solutions into domestic law or at least a version of them[10281029].

With effect, the 2021 Portuguese State Budget adds to the existing PE concept part of the DAPE concept's new aspects, replicating Action 7's dual approach (legally or economically binding) and keeping the express references to contract intermediation, contracts binding towards the principal and within the latter's activity; the anti-fragmentation rule; and the closely related concept[1030].

[1025] PORTUGUESE CORPORATE INCOME TAX CODE – Implemented by Decree-Law… [Considera-se estabelecimento estável qualquer instalação fixa através da qual seja exercida uma atividade de natureza comercial, industrial ou agrícola]; XAVIER, Alberto – *Direito Tributário Internacional*… p. 311; MACHADO, Jónatas E. M.; COSTA, Paulo Nogueira da – *Manual de Direito…* p. 323.

[1026] PORTUGUESE CORPORATE INCOME TAX CODE – Implemented by Decree-Law…; XAVIER, Alberto – *Direito Tributário Internacional*… p. 340.

[1027] PORTUGUESE CORPORATE INCOME TAX CODE – Implemented by Decree-Law…; XAVIER, Alberto – *Direito Tributário Internacional*… pp. 340-341.

[1028] 2021 PORTUGUESE STATE BUDGET – Law no. 75-B/2020…; JIMÉNEZ, Adolfo J. Martín – *Chapter 2: Tax Avoidance and Aggressive Tax Planning as an International Standard – BEPS and the "New" Standards of (Legal and Illegal) Tax Avoidance* In DOURADO, Ana Paula ed. – *Tax Avoidance Revisited in the EU BEPS Context*. Books IBFD. 2017. p. 10.

[1029] The 2021 Portuguese State Budget also introduces a provision on activities of exploration and exploitation of natural resources through installations, platforms or vessels, subject to a 90-day threshold, typical of natural resources-rich countries.

[1030] 2021 PORTUGUESE STATE BUDGET – Law no. 75-B/2020…; TEIXEIRA, Manuela Duro – *Portugal – Permanent Establishments*…

However, this reform leaves out several of Action 7's key features, notably, the independent agent status remains unchanged and keeps an express reference to commissionaires as an agent of independent status; the project PE's anti-splitting rule is absent, despite having been modified; and the specific activity exemptions still does not submit all activities to the preparatory or auxiliary test, although it removes delivery activities from its scope[1031].

Herein, we recall previous comments to clarify that Portugal traditionally follows the view that the specific activity exemptions provision's first compartment of paragraphs is inherently preparatory or auxiliary, thus the exemption automatically applies to them[1032].

This reform is also noteworthy because the domestic PE concept's wording is now closer to article 5 UNMC than its OECDMC's counterpart[1033], as it includes a service PE clause and it excludes delivery activities from the specific activity exemptions, grafting them onto the DAPE concept, both aspects typical of the UNMC[1034].

Considering our previous comments, we find it odd for Portugal to be embracing the UNMC, traditionally associated with developing countries, instead of the OECDMC, departing from its tradition, historic positioning and economic status, as a developed country and an OECD and EU member[1035]. Regrettably, there is no official justification as to this policy shift.

Likewise, and with severe practical consequences, the domestic PE concept's reform resembles a frankenstein-ish assortment of provisions absent of proper and detailed discussions over the provisions that should be modified and the path that should be taken within a concrete strategy. Unfortunately, this reform failed to have stakeholders involved in its design and planning, as per other reforms.

[1031] *Ibid*; PORTUGUESE CORPORATE INCOME TAX CODE – Implemented by Decree-Law…
[1032] TEIXEIRA, Manuela Duro – *Portugal – Permanent Establishments*…; XAVIER, Alberto – *Direito Tributário Internacional*… pp. 313-314, 339-340.
[1033] Similar to the Portugal-Angola DTT.
[1034] 2021 PORTUGUESE STATE BUDGET – Law no. 75-B/2020…; TEIXEIRA, Manuela Duro – *Portugal – Permanent Establishments*…; UN – *Model Double Taxation Convention between Developed and Developing Countries: 2017 update*. United Nations. New York, 2017. Available at: https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf
[1035] DOURADO, Ana Paula – *Portugal* In *Assessing BEPS*… p. 652; TEIXEIRA, Manuela Duro – *A Determinação do*… pp. 22-23; XAVIER, Alberto – *Direito Tributário Internacional*… pp. 311, 337.

As stated, we uphold that all activities within the specific activity exemptions should be submitted to the preparatory or auxiliary test to effectively prevent the artificial avoidance of PE status, therefore we must disagree with Portugal's decision to not amend this provision following the 2017 OECDMC. Only from Portugal's historical position on this provision can this stance be understood, nevertheless, it remains an unfortunate decision that perpetuates a loophole for MNEs' BEPS practices.

Furthermore, keeping the existing independent agent status provision together with the novel DAPE provision is bizarre, as it provides a safe-harbour to commissionaire arrangements at the same time it seeks to target these arrangements with an economic approach. This decision appears to provide a weapon to the Portuguese tax authorities without supplying the ammunition.

This decision is particularly disturbing since Portugal opted to implement a disproportionate provision with unwanted spillover impacts, without improving it, and chose to leave out an important and mostly adequate provision on the prevention of the artificial avoidance of PE status that would bring the independent agent status closer to the "*bonafide* agent", leading to uncertain results vis-à-vis MNEs' BEPS practices, especially those where group membership takes centre stage.

Due to the 2021 Portuguese State Budget's PE reform, we anticipate a surge in disputes and litigation between the Portuguese tax authorities and taxpayers.

Then again, this reform grants the Portuguese tax authorities sufficient weapons and ammunition to target and combat MNEs that are artificially splitting comprehensive business operations between closely related enterprises to exploit the specific activity exemptions provision, even if less successful than they would be if all activities were submitted to the preparatory or auxiliary test.

Also, there is a subtle, but crucial, difference between the domestic anti-fragmentation rule and the one from Action 7, as the former has partially limited its scope by requiring that the relevant fixed place of business, or stock of goods or merchandise, constitutes a PE for the enterprise or the closely related enterprise,

and not that either that place or the other place constitutes a PE for either enterprise, as does Action 7 and the OECDMC[1036].

This difference significantly diminishes the anti-fragmentation rule's application and effectiveness, as it mostly focuses on the place of the relevant fixed place of business, or stock of goods and merchandise, and not also on the other place, limiting this provision's anti-abusive attraction force and bequeathing MNEs with a loophole to continue to artificially avoid PE status.

In this reform, Portugal understood the current global economy and some of the MNEs' innovative strategies that use cutting-edge technology, especially those in the internet-based retail sector, since an enterprise shall be deemed to have a DAPE in Portugal whenever a person maintains in Portugal a stock of goods or merchandise for the delivery of such goods or merchandise on the enterprise's behalf, even if that person has no involvement on the contracts made[1037].

This strategic addition, derived from the UNMC, paired with removing delivery activities from the specific activity exemptions provision leads to an outcome similar to that of article 5 2017 OECDMC vis-à-vis the internet-based retail sector and similar MNEs' strategies, a less exploitable PE concept and restored source taxation.

Overall, the reformed domestic PE concept falls short of what was required and expected, as it was not a plethora of inharmonious provisions prone to misleading results and disputes. Also, the reform failed to improve Action 7's solutions, it even worsened some, and kept provisions prone to artificial avoidance and cherry-picked parts of troubling new provisions, removing them from the solution as a whole.

Still, the domestic PE threshold is effectively lower, not at Action 7's standards, but still, it is expectable that the number of PEs in Portugal will rise and so should Portuguese taxation, as the Source Country, the exact extension of which still needs to be verified. Also, the new provisions will naturally lead to added legal uncertainty, disputes and litigation, and new loopholes and mismatches will join the ones that were not addressed.

It stands clear that it was not only on its DTT network that Portugal had remained dormant before the tremors caused by the BEPS Project, denoting its

[1036] PORTUGUESE CORPORATE INCOME TAX CODE – Implemented by Decree-Law…
[1037] *Ibid*.

idleness to reformulate its long-standing concepts and to effectively prevent the artificial avoidance of PE status, similar to other areas, at least until 2021[1038]. Perhaps the domestic PE concept's reform will trigger some action on Portugal's DTT network as well.

However, based on the 2021 PE reform, any future action within the Portuguese PE concept should be preceded by comprehensive analysis and broad discussion towards the designing and implementation of a harmonious and balanced upgrade to the Portuguese PE concept, domestic or DTT. Preferably starting with the refinement of the substandard 2021 PE reform.

5.2. The Portuguese PE concept and the MLI – effects on Portuguese DTTs

As noted, Portugal's DTTs' PE concept remained generally oblivious to Action 7's solutions, as did Portugal's domestic concept until 2021. However, this statement might only be partially true because Portugal is a party to the MLI, meaning that its DTTs' PE concept may have been upgraded and consequently aligned with the new standard.

On adhering to the MLI Portugal did not remained dormant, it deposited its instrument of ratification on February 28th, 2020 and the MLI entered into force on June 1st, 2020, in respect of the Portuguese CTAs[1039]. In fact, Portugal was among the first countries to embrace the MLI, as a signatory at the initial signing ceremony, a statement of support and endorsement to the MLI[1040].

The above analysis established a baseline, based on which we will address Portugal's stance on the MLI and how it may affect its DTT network.

5.2.1. Portugal's position on the MLI

From Portugal's enthusiastic reaction to the MLI in the initial process, a complete acceptance of its articles could be anticipated, however, our analysis on

[1038] DOURADO, Ana Paula – *Portugal* In *Assessing BEPS*… pp. 663-664.
[1039] OECD – *Signatories and Parties*…
[1040] *Ibid*.

the Portuguese notification upon depositing its instrument of ratification reveals a significantly different scenario regarding the MLI's PE provisions[1041].

As noted, since the MLI's part IV is not a minimum standard, countries have the flexibility to choose whether or not they apply it on their CTAs, and to what extent[1042].

This leeway grants countries the opportunity to deploy different strategies when making their notification upon depositing their instrument of ratification, from an initial complete reservation, to monitor their CTA counterparts' progress, and then loosening their reservations based on the national and bilateral interests; to a complete acceptance of all articles, to take a leading role and influence others to take action[1043].

In this context, Portugal's latest notification to the MLI's Depository reveals caution over the effects the MLI might have on its DTTs, as it cherry-picked the articles and provisions relevant for its CTAs considering its general standpoint on the PE concept and the impacts the new PE standard might have on its tax national interests via its CTAs[1044].

Portugal reserved its right not to apply articles 12 and 14 MLI to its CTAs and did not elect an option on article 13 MLI, meaning that its CTAs specific activity exemptions provisions will remain untouched, thus Portuguese CTAs shall only be modified by the addition of article 13 (4) MLI's anti-fragmentation rule and article 15 MLI's closely related concept[1045].

[1041] *Ibid*.
[1042] KLEIST, David – *The Multilateral Convention*… pp. 34-35; BRAUNER, Yariv – *McBEPS: The MLI*… pp. 9-11.
[1043] BRAUNER, Yariv – *McBEPS: The MLI*… pp. 10-11, 13.
[1044] OECD – *Signatories and Parties*…; NOTICE OF THE FOREIGN AFFAIRS MINISTER NO. 37/2020 – of 14 July [Aviso do Ministério dos Negócios Estrangeiros n.º 27/2020, de 14 de Julho].
[1045] *Ibid*; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… p. 53.

Regarding CTAs, Portugal made a comprehensive notification, listing almost all its DTTs, including the ones that are not in force[1046], but not the Portugal-Angola DTT[1047], already generally MLI compliant[1048].

By reference to September 2021, 44 of the Portuguese CTAs have been affected by the MLI, as the relevant counterparty deposited its instrument of ratification, meaning that their PE concept may have been amended as per Portugal's position on part IV, subject to effective matching [10491050].

Portugal's stance on the MLI's PE concept serves as evidence of the alerts made on divergent county practices and the BEPS Project and the MLI's general inability to enforce a consistent and coherent implementation of Action 7.

Although swift, three years from signature to entry into force, Portugal's implementation of the MLI's solutions to prevent the artificial avoidance of PE status is far from consistent and homogeneous vis-à-vis Action 7, the MLI and the 2017 OECDMC[1051].

Furthermore, initial thoughts that Portugal's MLI stance could be aligned with its general standpoint on the PE concept are dismissed upon comparing its MLI notification with its position on the 2017 OECDMC, in which it did not make any reservation or observation to the novel provisions and interpretations; and also with the Portugal-Angola DTT, negotiated and entered into force following Action 7, the MLI and the 2017 OECDMC, where the DAPE provisions are included[1052].

[1046] The Portugal-Finland DTT and the Portugal-Sweden DTT, unilaterally terminated by Finland and Sweden, respectively, and the Portugal-Timor-Leste DTT, pending the ratification process conclusion.

[1047] The Portugal-Kenya DTT was approved after Portugal's latest MLI notification, however, it is not yet in force and has not yet been designated as a CTA.

[1048] OECD – *Signatories and Parties*…; NOTICE OF THE FOREIGN AFFAIRS MINISTER NO. 37/2020 – of 14 July; DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… p. 50.

[1049] We refer to the detailed description of the first 31 Portuguese CTAs to have been affected by the MLI by Rodrigo Rabeca Domingues, Catarina Manana Nunes and João Ochôa on their compilation: DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral Enquadramento e Impacto nas Convenções para Evitar a Dupla Tributação Celebradas por Portugal.* Coimbra: Almedina, 2020. pp. 133-1048.

[1050] OECD – *Signatories and Parties*…; NOTICE OF THE FOREIGN AFFAIRS MINISTER NO. 37/2020 – of 14 July.

[1051] *Ibid*; PORTUGUESE TAX AUTHORITY – *List of Portuguese*…; OECD – *Model Tax Convention*… 2017.

[1052] *Ibid*.

Considering these three official Portuguese positions on the new PE concept, no pattern or common approach is identifiable[1053]. This scattered Portuguese stance is prone to misinterpretations and will mislead interpreters and interested parties looking at Portugal as an investment or business opportunity. Also, it may create loopholes for MNEs to explore and continue to artificially avoid PE status, leading to disputes. It is also worth considering that for CTAs affected by the MLI, their PE concept is generally broader, with a lower threshold, than the domestic concept[1054].

Unfortunately, Portugal serves as evidence of the detrimental effects that come from the inharmonious and inconsistent implementation of the provisions to prevent the artificial avoidance of PE status, due to their flexibility, and, at the same time, it proves what many stakeholders explained about the BEPS Project, that divergent country implementation of DTT-related provisions is a reality and that it may negatively affect its outcome.

Still, we hope that Portugal will not become evidence of the damaging side-effects and spillover impacts of the MLI and the 2017 OECDMC's PE concept, especially from the anti-fragmentation rule and the DAPE concept.

Portugal's dispersed stance on the PE concept also appears to make a statement on the countries' interpretation and view of the MLI, where their position therein does not reflect the one taken in different contexts, namely in DTT bilateral negotiations, reinforcing the concerns that countries still favour bilateral renegotiations.

Albeit Portugal was not dormant regarding its DTTs vis-à-vis the MLI following the BEPS Project's tremor, its action in this regard has been kept contained around the MLI's ratification, absent of active DTT bilateral renegotiations following the BEPS Project.

[1053] *Ibid*.

[1054] DOMINGUES, Rodrigo Rabeca; NUNES, Catarina Manana; OCHÔA, João – *A Convenção Multilateral*… pp. 53-54.

5.3. The future of the Portuguese PE concept

Thus far, we explained and presented the current Portuguese PE concept and Portugal's state of compliance with the BEPS Project on the PE concept, which is still less than ideal, with poor decisions on its domestic legislation, a heavily reserved position on the MLI, and a single DTT that is generally Action 7 compliant, thus paving a path prone to loopholes and mismatches for MNEs to thrive.

Therefore, Portugal is not winning the fight against MNEs and BEPS practices that artificially avoid PE status, hence quick and immediate response is required to strengthen and improve the domestic and international taxation system, to limit MNEs reaction time and adaptability to the new panorama.

In this context, we will attempt to provide a glimpse of the Portuguese PE concept's future, based on available indicators and assess if it is pursuing the right path.

Regarding DTTs, the best indicators available are the official position on the MLI and the Portugal-Angola DTT, as there has been no updated guidance from the Portuguese tax authorities nor has there been any announcement of ongoing bilateral negotiations of DTTs[1055].

Still, as noted, these indicators do not form a viable baseline capable of forecasting Portugal's future path on its DTTs PE concept, however, the common denominator to both indicators could encompass Portugal's minimum commitment to the new PE concept.

In this sense, the anti-fragmentation rule and the closely related concept stand as these indicators' only common features, therefore, it can be extrapolated that future Portuguese DTTs shall include these provisions[1056].

As noted regarding the Portugal-Angola DTT, there is one aspect that stands out when comparing it to other recent Portuguese DTTs, its PE concept is a near replica

[1055] Nonetheless, it is known that a protocol to the Portugal-Sweden DTT has been negotiated and is pending to go through Portugal's domestic approval process, however, this protocol does not address PE matters and Sweden has unilaterally terminated this DTT. Also, the Portugal-Germany DTT is under renegotiation since 2017, however, the works have not yet begun. Interesting enough, neither country included their DTT with Portugal on their MLI notification as a CTA.

[1056] OECD – *Signatories and Parties*…; NOTICE OF THE FOREIGN AFFAIRS MINISTER NO. 37/2020 – of 14 July; PORTUGUESE TAX AUTHORITY – *List of Portuguese*…

of that of the UNMC, instead of the one from the OECDMC[1057]. This may either arise from the Angolan DTT practice, traditionally closer to the UNMC, or be the first signal of a Portuguese policy shift, however, a single DTT does not provide sufficient data to elaborate further on it.

With a foreseeable minimum common denominator for the future Portuguese DTT PE concept established, it is also worth addressing the recently amended domestic PE concept. As noted, Portugal has only recently modified its domestic PE provision as per the BEPS Project's aftershocks, despite being at the BEPS Project's forefront[1058].

Also, considering Portugal's strategic placement within the global economy and the geopolitical panorama, the new domestic provision should be quickly revised, preferably by improving Action 7's solutions and recovering its OECDMC tradition. Even more so since Portugal is among the countries whose view of the PE concept allows MNEs' BEPS practices to thrive and damage the domestic and international taxation system, and the local and global economy. Therefore, it requires a proper reform of the domestic PE concept.

5.4. Preliminary conclusions

Considering the PE concept's inherent international/external nature, we analysed it from a DTT and domestic perspective, providing an ample and comprehensive view of its current state, the envisaged evolution and a possible future, all in connection with the BEPS Project and its aftershocks.

Portugal's PE concept remained mostly dormant during the international taxation system's quakes, showing just flimsy signals of minor rumbles, as opposed to the expected significant local tremble with a proper DTT and domestic PE concept reform, at least until 2021.

[1057] PORTUGUESE TAX AUTHORITY – *List of Portuguese*…; UN – *Model Double Taxation*…
[1058] DOURADO, Ana Paula – *Portugal* In *Assessing BEPS*… pp. 650-652, 660-661.

However, in 2021, much like a bear leaving winter hibernation, Portugal finally woke up and abandoned its pre-BEPS PE concept's grotto, causing trembles with its domestic PE concept's reform.

Portugal's PE concept and DTT practice have been closely aligned with the OECDMC, particularly since the 1999 reform as evidenced by its DTT network, however, the recent domestic PE reform appears to be breaking from this tradition and embracing the UNMC, sending mixed signals as to the path Portugal will pursue within the PE concept. Portuguese DTTs still follow closely the PE concept's pre-BEPS version, except for the Portugal-Angola DTT which is already mostly BEPS compliant.

Still, Portugal's general commitment to the MLI is remarkable, as most of its DTTs were notified to the MLI Depository as CTAs, except the Portugal-Angola DTT as it is MLI compliant.

However, Portugal's effective MLI commitment on the PE concept is far inferior, as only two of part IV's provisions have a chance of affecting its CTAs, contingent on effective matching, *i.e.*, the anti-fragmentation rule and the closely related concept.

Therefore, Portugal's devotion to the prevention of the artificial avoidance of PE status is rather unsatisfactory, especially considering Portugal's stance and view on this concept, which makes it highly susceptible to exploitation by MNEs.

Domestically, despite Portugal's initial torpor following the BEPS Project's quake, where it was actively involved, and subsequent reverberations, it finally rose from its slumber and the domestic PE concept was upgraded through the 2021 Portuguese State Budget, which could also spark the start of bilateral renegotiations of its DTTs, thus taking bolder action on the PE concept, beyond its MLI stance.

Furthermore, based on its last DTT and the 2021 Portuguese State Budget's wording, Portugal appears to be shifting its PE concept's position towards the UNMC, as opposed to its traditional OECDMC stance. This is a surprising paradigm shift, and, thus far, no explanation has been made public, potentially misleading interpreters, including courts, which often rely upon the OECDMC and its Commentary on PE-related matters.

The disparity between Portugal's stances on the PE concept is baffling, with significant divergences between them and no identifiable strategic path or pattern

when considering the choices made on the MLI, the Portugal-Angola DTT, and the 2021 Portuguese State Budget's wording, other than the apparent Portuguese PE concept's minimum standard, *i.e.*, the anti-fragmentation rule and the closely related concept.

Portugal was dormant in the fight to prevent the artificial avoidance of PE status, standing on the side-lines and watching others advance, however, Portugal tried to recover its place at the PE concept's vanguard through the domestic PE's reform, by implementing some of Action 7's solutions and lowering its threshold, in an effort to nullify BEPS strategies and erase loopholes and mismatches, which could strengthen Portugal's tax revenue with the recovery of lost source taxation.

Nevertheless, the Portuguese PE concept's reform should have taken into consideration the alerts and concerns raised by stakeholders and should have only occurred upon strenuous analysis of the provisions and their strategic implementation, however, the evidence clearly indicates otherwise, as the current domestic PE concept stands as a bizarre patchwork. Consequently, it is paramount to review and correct the domestic PE concept's reform, preferably before nefarious effects arise from its ill-conceived outcome.

This marks the conclusion of our analysis on the Portuguese PE concept, which also serves as a stepping stone for the final Chapter, the future of the PE concept.

CHAPTER 6: THE FUTURE OF THE PERMANENT ESTABLISHMENT CONCEPT – Beyond the Aftermath

The preceding Chapters analysed the PE concept's reality before and during the BEPS Project's quake and aftershocks and assessed this concept's metamorphosis throughout them.

Consequently, they established a sturdy and detailed baseline of the PE concept's past and present features, aspects and concerns that allow extrapolating this vital element of the international taxation system's future. An element that has been present and operational for over 100 years and may very well continue for another 100 years, provided that it is routinely reviewed and improved.

Therefore, we will focus on the PE concept's issues that were not addressed in its recent update, even though they should have been to strengthen and improve this concept to prevail in a fast-moving and technologically advanced reality, without renouncing its core nature and features.

In these quakes' aftermath, once the dust settles and the rubbles are sorted, it is imperative to look ahead and take the opportunity to innovate in the reconstruction while embracing the path taken thus far.

Beyond addressing unattended issues, we will also unveil our vision for the PE concept's future, especially considering the ruckus and discussion around this subject, with different positions and no clear path yet carved.

6.1. Forgotten pre-existing illnesses

Although Action 7 could be renowned as the PE concept's deepest reform in recent times, its purpose from inception was not to address all of the PE concept's identified deficiencies, rather it was a precision work done on selected topics connected with BEPS practices.

Hence, there are aspects of the PE concept that still raise concerns or that can be improved to bring this concept up to its full capacity within the international

taxation system as a vital component for taxing rights' allocation and the equilibrium of source-residence taxation.

6.1.1. Objective thresholds

Among the PE concept's issues that were, and should continue to be, raised is a clear and express threshold for the *tempus* test, particularly relevant for the physical PE and a guideline throughout article 5 OECDMC.

Across the globe, countries follow a rather stable common practice on the *tempus* test, where its fulfilment stands on an *ad hoc* 6-month threshold for an enterprise to be deemed to have a significant presence in the relevant country[1059].

However, the fact that some countries generally follow this *ad hoc* practice does not provide any legal certainty for foreign persons willing to embrace cross-border business activities, as such practice is merely indicative and the *tempus* test might be fulfilled in a shorter period, thus potentially triggering PE status, which is a potential deterrent to cross-border trade[1060].

There is an intrinsic difficulty in the assessment of this test based solely on DTTs and the OECDMC Commentary. The benefits of having a minimum threshold in the PE concept have been known for some time and are several, for taxpayers and tax administrations alike, such as increased legal certainty, improved ability to enforce taxation on foreign taxpayers and reduction of unwanted administrative costs[1061].

In fact, the PE concept is itself a sort of minimum threshold, given that a foreign person has a PE in a country only when its business activity therein surpasses a certain level, and, within this concept, we also find a quantitative threshold in the project PE, *i.e.* the 12-month test[10621063].

Despite knowing the benefits, already having a similar feature in the PE concept and being conscious of the countries common practice, the OECD has yet to take

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[1059] REIMER, Ekkehart; RUST, Alexander eds. – *Klaus Vogel on*… pp. 346-347; OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 28.
[1060] ARNOLD, Brian J. – *Threshold Requirements for Taxing Business Profits under Tax Treaties*. Bulletin for International Taxation. Volume 57, number 10 (2003) p. 482.
[1061] ARNOLD, Brian J. – *Threshold Requirements for*… pp. 482-483; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 52-53.
[1062] A shorter time threshold is also generally found on the service PE.
[1063] ARNOLD, Brian J. – *Threshold Requirements for*… pp. 478-480, 483-486; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 53.

action to enshrine in the PE concept and the OECDMC an objective 6-month threshold, which could be applied throughout article 5 OECDMC, excluding the project PE[1064].

In this context, we support the implementation of an objective 6-month time threshold within article 5 OECDMC, as it would greatly improve legal certainty and reduce compliance and administration costs for taxpayers and tax administrations over less substantial cross-border business activities[1065].

We are mindful of the issues connected with an objective threshold, such as being prone to abuse and artificial avoidance, however, in the current PE concept and OECDMC's context, both stocked with anti-abuse provisions, it is fair to assume that abusive or avoidance situations would be limited, especially if the anti-splitting and anti-fragmentation rules are expanded and adapted to also cover these situations.

A similar experiment has already been implemented to some extent in the new Germany-Australia DTT for its service and project PE[1066]. Under this DTT, where a person segregates a consistent business activity between closely related persons so that each carries out a connected portion of that business activity, and each portion is deemed to be complementary to that cohesive business operation, and each person carries out these activities for over 30 days, then each of those periods should be aggregated for the computation of the overall time spent in that country by the relevant person pursuant to the *tempus* test[1067].

Still, for a PE to exist all others tests must be fulfilled, however, the combined efforts of the time threshold and the anti-abuse provision could greatly improve the PE concept.

Furthermore, as our proposal would be integrated into the existing concept, it would benefit from another tier of protection for special unique recurring situations where a business activity's whole purpose and objective is fulfilled in a shorter

[1064] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 28; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 52-53.
[1065] ARNOLD, Brian J. – *Threshold Requirements for*… pp. 482-486.
[1066] MAURER, Ludmilla [et. al.] – *A Brave New*… p. 318.
[1067] *Ibid*.

period due to its characteristics or those of its sector, such as sports events, music festivals, conferences, fairs and similar events[1068].

Alongside the objective time threshold, we also support the introduction of a revenue-based quantitative threshold, where a person engaged in cross-border business activities would not be deemed to have a PE if its gross revenue from the relevant country is below a determinable amount[1069].

This threshold would further increase legal certainty and reduce compliance and administrative costs for taxpayers and tax administrations and could also encourage smaller companies to expand and go international, thus growing the global economy without initial taxation barriers[1070].

Furthermore, albeit it is vital for countries to collect taxes to support state budgets, it is just as relevant that the taxes collection process's costs are not higher than the taxes effectively collected, it is important to have rational and efficient processes, despite scalability, and able tax administrations[1071]. It stands clear that if a country spends 20 to collect 15 in taxes, then its taxation system is not efficient, as it will be in a continuous deficit.

This type of threshold is also not a novelty in the international taxation system, yet the OECD appears unwilling to take bolder actions, as opposed to other countries and organizations, for instance, a variation of a quantitative threshold can be found in the USA's Multistate Tax Commission's Nexus program, in the European Commission's draft directive on a significant digital presence's corporate taxation[1072], and some of Action 7's discussion drafts[1073].

Although the OECDMC could set a standard gross revenue amount per tax period for this threshold (*e.g.* 500,000.00 euros), this value should be subject to

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[1068] OECD – *Model Tax Convention*… 2017. Commentary on article 5 para. 28-30.
[1069] ARNOLD, Brian J. – *Threshold Requirements for*… pp. 487-488.
[1070] *Ibid*; HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 38-40; BARBIER, Casper – *The Permanent Establishment*… pp. 78-80.
[1071] HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 38; ARNOLD, Brian J. – *Threshold Requirements for*… pp. 482-483; BARBIER, Casper – *The Permanent Establishment*… p. 78; ROSDINA, Haula; TAMBUNAN, Maria R.U.D.; IRIANTO, Edi Slamet – *Review of Implementation*… pp. 635, 638.
[1072] EU – Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, COM/2018/0147. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018PC0147.
[1073] KOSTIC, Svetislav V. – *Chapter 3: New*… pp. 13-14; BARBIER, Casper – *The Permanent Establishment*… p. 74; HÄGGLUND, Camilla Berkesten – *The Definition of*… p. 38.

inflation rates and adjusted considering the economic reality of the countries negotiating DTTs and their standard international trade currency (to avoid domestic currencies value oscillations)[1074].

Also, anti-abuse provisions would have a significant role, and like in the time threshold, the anti-splitting and anti-fragmentation rule could be expanded and adapted to prevent abuse and artificial avoidance herein.

Both thresholds could be a relevant addition to the PE concept and the international taxation system, providing further clarity and certainty while fostering the rise and expansion of smaller business activities and their leap onto cross-border ventures, where tax revenue would, in any case, be immaterial[1075].

Besides, these proposals could have a key role for developing countries, as the effect of removing minor cross-border business activities from the PE concept would reduce these countries' tax administrations' administrative and compliance burden, which are traditionally less prepared than those of developed countries, thus preventing overbearing cases where the costs could outweigh the benefits arising from the eventual collection of tax[1076].

Even more so considering that taxation is essential for these countries' state budgets and source taxation is often scarce due to the artificial avoidance of PE status, although it is in these countries where value is often created and where there is significant economic presence[1077]. Despite relinquishing a portion of tax revenue, the overall balance with the associate costs should still compensate for it.

Furthermore, taxation where value is created would not be abandoned in total, in fact, this threshold's cross-border trade incentive feature could attract further business activities and local taxation[1078].

There are already important examples of going further into bringing taxation closer to where value is effectively created, particularly relevant for developing

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[1074] ARNOLD, Brian J. – *Threshold Requirements for*… pp. 487-488.
[1075] HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 38-40; BARBIER, Casper – *The Permanent Establishment*… p. 78.
[1076] HÄGGLUND, Camilla Berkesten – *The Definition of*… pp. 38-40; DOURADO, Ana Paula – *Governação Fiscal Global*… p. 52; AHMED, Muhammad Ashfaq – *Pakistan: Bracing for*… p. 339.
[1077] MORAIS, Rui Duarte – *Apontamentos ao IRC*. Coimbra: Almedina, 2007. pp. 24-25; AHMED, Muhammad Ashfaq – *Pakistan: Bracing for*… p. 339.
[1078] ARNOLD, Brian J. – *Threshold Requirements for*… p. 483; BARBIER, Casper – *The Permanent Establishment*… p. 78.

countries, such as the contract manufacturing provision in the Germany-Australia DTT, which goes further into the path to international equality[1079].

6.1.2. Modernization

Another aspect addressed in the 2014 OECDMC, and that continues valid, relates with article 5 OECDMC's lack of contemporaneity, especially in article 5 (2) and (4).

The PE concept is a key component of the international taxation system, which in its turn is vital to the global economy, which is in constant mutation due to technological innovation, thus it cannot be said that the global economy is timeless and neither are its players nor can certain concepts be.

Despite its remarkable longevity, the PE concept is not timeless, nor should it be; in fact, the bulk of the issues identified in Action 7 were related to this concept being outdated vis-à-vis the current global economy.

Therefore, it is imperative to update the PE concept to present times and that it continues to be modernized in dynamic modifications, growing alongside the evolution of the global economy while maintaining its foundation.

In this sense, we reckon that article 5 (2) and (4) OECDMC should be revised and updated to include modern examples of physical PEs and of activities that often have a preparatory or auxiliary character.

Also, both exemplifications should be expanded to cover the DAPE concept, hence providing greater legal certainty to taxpayers and tax administrations alike, potentially reducing disputes, for instance, sales agents as an example of DAPE and marketing/promotional activities and control and verification of information (*e.g.*, KYC procedures) as examples of activities that often have a preparatory or auxiliary character.

6.1.3. DAPE concept integration

The final forgotten aspect of the PE concept that we highlight and that should be addressed is the connection between article 5 (5) and (6) OECDMC, which would

[1079] MAURER, Ludmilla [et. al.] – *A Brave New*… pp. 315-316; OECD – *Preventing the Artificial*… p. 3; MACHADO, Jónatas E. M.; COSTA, Paulo Nogueira da – *Manual de Direito…* pp. 180-181.

greatly improve the interpretation and application of the DAPE concept in actual situations, potential diminishing disputes between taxpayers and tax administrations.

Throughout this thesis, we have supported the integration theory as the most suitable one to connect both DAPE concept's provisions and we continue to do so[1080].

However, astonishingly the OECD has not yet taken a substantial and definitive step regarding the way to interpret these two interconnected provisions and how they are effectively linked, thus hindering legal certainty and this concept's interpretation.

The OECD should address these focal points of discussion within the PE concept and work to effectively supplant them, thus improving and strengthening it.

We have selected three pertinent aspects that lack proper attention from the OECD and that are a cause for concern over the PE concept's interpretation and application, to draw attention towards their needed revision.

Action 7 was an important milestone, and despite its many defects it can still be regarded as somewhat of a success for achieving a substantial reform of the PE concept, however, this concept is not reduced to the aspects dealt with therein, many other of its elements are just as important and they also require improvement to achieve a better concept as a whole, and not a partially wobbling one.

6.2. A future for the PE concept?

In this thesis's final act, we take a cursory look at the PE concept's future and disclose our vision for it. The PE concept has been, and will likely continue to be, in a state of flux, with the digital and dematerialized economy's activities as the main disrupters, apart from abuse and avoidance practices, as these challenge this

[1080] PIJL, Hans – *Agency Permanent Establishments* […] *Part 1*… pp. 4-5; PIJL, Hans – *Agency Permanent Establishments* […] *Part 2*… pp. 84-96.

concept's foundation, focused on physical presence, and are mostly able to elude its wide net due to their very nature[1081].

We are gradually evolving into an increasingly digitalized economy as a consequence of technological progress, where more and more business activities are being conducted and generating value in a dematerialized fashion, either partially (*e.g.*, e-commerce retailers) or fully (*e.g.*, internet-based services such as cloud computing), and yet these are not being adequately taxed for their business profits, particularly at source, as they are able to elude current rules[1082].

Therefore, taxation should, and needs, to accompany these technological leaps of business activities, to not generate distortions between economic sectors, where some are taxed, and others remain on a tax-free no man's land[1083].

However, it is worth remembering that although we are living and experiencing the digital and dematerialized economic marvel, this does not count as the whole global economy, where physical presence still plays a humungous role, and there are several economic areas where digitalization and dematerialization will hardly become a reality, such as the primary and secondary sectors, and parts of the tertiary sector. It is also evident that the digital and dematerialised economy will always have physical links, at least in its users and customers as its source of income[1084].

In fact, the digital economy is generally valued as accounting to 15%, or less, of the global GDP, varying per definitions and studies, nonetheless, this rough estimation suffices for this thesis's purposes, making clear that the economy is still not digital, despite existing digital nuances across it[1085].

[1081] DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… pp. 303-304; CASTELLO, Dario – *Is this the end of the Permanent Establishments? An inquiry from the past to the future of the PE concept in a post-BEPS world*. 2019. Tilburg. Master thesis. pp. 41-42; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… p. 199.

[1082] DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… pp. 303-304; CASTELLO, Dario – *Is this the*… pp. 41-42, 56-57; DHULDHOYA, Vishesh – *The Future of the Permanent Establishment Concept*. Bulletin for International Taxation. Volume 72, number 4a/Special issue (2018) p. 14; KOSTIC, Svetislav V. – *Chapter 3: New*… pp. 13-14; SPINOSA, Lisa; CHAND, Vikram – *A Long-Term Solution*… pp. 477-478; CUGUSI, Isabella – *Prospects for Taxation of the Digital Economy between "Tax Law and New Economy" and Tax Law of the New Economy*. World Tax Journal. Volume 12, number 4 (2020) pp. 767-768.

[1083] CASTELLO, Dario – *Is this the*… pp. 41-42.

[1084] DHULDHOYA, Vishesh – *The Future of*… p. 14; CALABRESE, Mattia – *Chapter 5: Taxing*… p. 2.

[1085] UN – *Digital Economy Report 2019 – Value Creation and Capture: Implications for Developing Countries*. United Nations Conference on Trade and Development. New York, 2019. Available at:

Consequently, the international taxation system should not lose itself when taxing the digital economy, it is fundamental that it finds a balance between the traditional economy and the digital sector, one that is capable of adequately taxing both realities without damaging itself in the process[1086].

It is in this context that the PE concept has been under the spotlight for quite some time, with many contemplating transfiguring this concept into a weapon to tax the digital sector, *i.e.*, a digital PE concept to establish a taxation nexus, among other alternatives (such as the OECD's two-pillar strategy[1087]), some of which are unilateral measures already mentioned[1088].

Although we recognize the proposed theories' merits, we reckon that any solution for taxing the digital economy should not distort the PE concept's present configuration, which stands on physical presence[1089].

The PE concept has been operational for over a century and, despite its inefficiencies, it has been a reliable, effective and adaptable element of the international taxation system, subject to regular-ish improvements and reforms whenever needed, due to business or technological developments, but without losing the physical presence nexus as its foundation[1090].

Although it may be easier and quicker, to adapt a known instrument, such as the PE concept, to tax the digital economy, we reckon that tax research on the digital sector should be conducted in parallel with technological, economic and scientific research, to adequately understand its core functioning and how and where a

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https://unctad.org/system/files/official-document/der2019_en.pdf; KOSTIC, Svetislav V. – *Chapter 3: New*… p. 14.

[1086] KOSTIC, Svetislav V. – *Chapter 3: New*… p. 14; CUGUSI, Isabella – *Prospects for Taxation*… pp. 765-766.

[1087] OECD – *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*. OECD. July 1st, 2021 Available at: https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.htm.

[1088] CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 4-5; KOSTIC, Svetislav V. – *Chapter 3: New*… pp. 13-14; CASTELLO, Dario – *Is this the*… pp. 42-43; DHULDHOYA, Vishesh – *The Future of*… p. 1; BARBIER, Casper – *The Permanent Establishment*… pp. 72-76; PIRES, Rita Calçada – *Manual de Direito*… pp. 89, 342-346, 359-360; MAISTO, Guglielmo [et. al.] eds. – *New Trends in*… pp. 201-203; CASTRO, Adriana Sánchez – *Administrative Capability Analsis of OECD Proposals from the Perspective of Developing Countries*. Intertax. Volume 48, issue 2 (2020) pp. 218-232; SPINOSA, Lisa; CHAND, Vikram – *A Long-Term Solution*… pp. 479-481, 493-494; CUGUSI, Isabella – *Prospects for* Taxation… pp. 765-768, 775-782.

[1089] PIRES, Rita Calçada – *Manual de Direito*… pp. 72, 88-89, 315-320.

[1090] CASTELLO, Dario – *Is this the*… pp. 55-57; DHULDHOYA, Vishesh – *The Future of*… pp. 1, 10, 14; PIRES, Rita Calçada – *Manual de Direito*… pp. 72, 88-89.

suitable nexus can be established for a reality in permanent mutation and evolution, prior to the technical drafting of new instruments or concepts[1091].

Part of the PE concept's success derives from its design, which is based on physical presence, so transfiguring this concept to suit a reality for which it was not designed or intended, exceeds its adaptability and is a shortcut that may hinder its current effectiveness and success as well as not producing satisfactory results in that new purpose, as it may not be an effective tool for it[1092].

Following the above, we find that issuing the PE concept's death certificate or claiming that it is obsolete is an overstatement and should be rebutted, instead, it may be more adequate to claim that, although effective and valuable to the international taxation system, it is simply not the most adequate weapon to address the digital economy and no better alternative has been found, or accepted, yet[1093].

The PE concept ought to keep its current framework, embracing its foundation and core elements, while dynamically progressing and evolving to annul its inefficiencies and shortcomings, thus assuring its sustainability; and focus its action on consensus and the effective combat against abuse and artificial avoidance of PE status, instead of rampaging with overbearing provisions that hinder the international taxation system and the global economy, and divergent solutions that foster mismatches and loopholes[1094].

Furthermore, it is crucial that the PE concept redirects its aim towards precise targets and goals, and abandon its catch-all strategy from Action 7's overly low threshold and extended scope and reach.

[1091] CALABRESE, Mattia – *Chapter 5: Taxing*… p. 5; KOSTIC, Svetislav V. – *Chapter 3: New*… p. 14; DHULDHOYA, Vishesh – *The Future of*… p. 14; PIRES, Rita Calçada – *Manual de Direito*… pp. 327-328; SCHÖN, Wolfgang – *One Answer to Why and How to Tax the Digitalized Economy*. Intertax. Volume 47, issue 12 (2019) pp. 1010-1022.

[1092] CASTELLO, Dario – *Is this the*… pp. 52, 56-57; DHULDHOYA, Vishesh – *The Future of*… pp. 10, 14; MORAIS, Rui Duarte – *Apontamentos ao IRC*… p. 31; PIRES, Rita Calçada – *Manual de Direito*… pp. 72, 88-89, 315-320.

[1093] DOS SANTOS, António Carlos; LOPES, Cidália Mota – *Tax Sovereignty, Tax*… pp. 303-304; PEREIRA, Paula Rosado – *Princípios do Direito*… p. 236; CASTELLO, Dario – *Is this the*… pp. 56-57; DHULDHOYA, Vishesh – *The Future of*… p. 14; MORAIS, Rui Duarte – *Apontamentos ao IRC*… p. 31.

[1094] CASTELLO, Dario – *Is this the*… pp. 55-57; DHULDHOYA, Vishesh – *The Future of*… p. 17; CALABRESE, Mattia – *Chapter 5: Taxing*… pp. 12-13; DOURADO, Ana Paula – *Governação Fiscal Global*… p. 102; PIRES, Rita Calçada – *Manual de Direito*… pp. 88-90.

As a final note, we hope the PE concept continues faithful to its founding principles, be continuously improved and be a pivotal element in the international taxation system's allocation of taxing rights.

6.3. Preliminary conclusions

In this thesis's final Chapter, we provided some observations on distressing elements within the PE concept and briefly addressed our vision for this concept, from which certain conclusions can be drawn.

The future PE concept must first address the issues that have not yet been resolved and that continue to hamper it, such as the lack of objective thresholds based on time and gross revenue that ought to provide greater certainty and reduce compliance and administration costs.

These objective thresholds also function as an indirect growth and expansion incentive for smaller enterprises, as taxation and administrative/compliance barriers would cease to exist. However, when their revenue and presence become relevant, thus achieving a significant economical presence in the relevant country, then those entities could be deemed to have a PE therein.

Furthermore, these thresholds also grant greater rationality and efficiency to countries' management and state budgets, as smaller cross-border ventures, which originate less tax revenue, would be excluded from local compliance and administrative obligations, meaning that tax administrations would not incur in costs with their assessment, particularly considering that the costs incurred often supplant the tax effectively collected from such minor endeavours.

Some PE concept's elements remain forgotten in time and were not properly addressed in past reforms to be in line with the way businesses are being conducted in the current global economy, reason why article 5 (2) and (4) OECDMC, should include contemporary examples of PEs and of activities that generally have a preparatory or auxiliary character.

Also, both provisions ought to be expressly expanded by having examples and activities typical of the DAPE concept included within each of them, thus providing greater cohesion to article 5 OECDMC.

Lastly, a definitive stance should be taken regarding the bond between article 5 (5) and (6) OECDMC, thus subsiding doubts over the DAPE concept's interpretation and application. We reckon that the discussed integration theory is the one that best suits this concept's purpose and objective.

Regarding our vision for the PE concept's future, we stand on a stricter split between the digital economy and the traditional one, with each side tailored to its particularities, creating a space between both realities like Moses splitting the sea, *i.e.*, the traditional economy with the PE concept and the digital and dematerialized economy with a bespoke nexus instrument that may bestow taxing rights upon the relevant country or that effectively taxes business activities arising from such sector in the relevant country, depending on the policy adopted.

The PE concept has been successful in addressing taxing rights allocation in the non-digital economy, thus it should continue to do so, together with reviews and updates when necessary, and an increased emphasis on combating abuse and artificial avoidance, but without mutating into a hybrid instrument.

Moreover, attempting to succeed in the digital and non-digital economy through a transfigured PE concept, based on its adaptability and success on the latter, might diminish its capabilities in the traditional economy and, at the same time, it might not become a suitable weapon against the digital economy's sub-taxation, thus leading to an unsatisfactory global outcome.

Physical presence lies at the nucleus of the PE concept's design and founding principles, thus it can hardly be suitable for the digital economy, as it would be the same to off-road in a Ferrari or eat soup with a fork.

Seeking a single solution for opposite realities might be counterproductive, there are better paths to achieve the intended goals, and a better nexus and taxation concept for this new and constantly evolving reality needs to be researched and designed.

The PE concept, absent mutational experiments, shall resemble a centennial tree, that despite quakes, revolutions, and plagues, if taken care of and nurtured, shall continue to bear fruit for times to come.

CONCLUSIONS

Ultimately, at this thesis's zenith, we compile our work's fundamental conclusions to tie the bow on it:

CHAPTER 1

1. The PE concept is a fundamental piece of the international taxation system through which taxing rights over business profits of non-resident persons are bestowed upon source countries, wherever such persons have a sufficient economic presence therein, thus regulating the tenuous residence/source taxation equilibrium.
2. This concept gravitates around a qualified physical presence in source countries as the key factor for its application, regardless of the relevant PE category. Our work focused on the physical, project and DAPE categories.
3. Article 5 2014 OECDMC failed to accompany the economy's technological and scientific leap and was significantly out of touch with reality on the new ways to conduct business activities, especially cross-border ventures.
4. This lagging effect fostered the rise of distortions between country practices and avoidance opportunities that were exploited by MNEs to elude source taxation and diminish their overall tax burden.
5. The PE concept's shortcomings are not reduced to those emerging from its idleness towards the advancing global economy, some of its issues are chronic and have been ignored for some time.
6. Article 5 (3), (4), (5) and (6) 2014 OECDMC were at the centre of the MNEs avoidance strategies and practices, which were possible due to mismatches and loopholes explored by MNEs and caused by divergent country practices, and article 5 2014 OECDMC's inability to fight and prevent them.
7. Therefore, the PE concept and article 5 2014 OECDMC were in dire need of substantial reform. Article 5 2014 OECDMC was the foundation upon which the PE concept's reform was designed and later implemented.

CHAPTER 2

8. The BEPS Project is a humongous undertaking that benefited from global political commitment, academic endorsement and the general society's support.

9. A particular worrying set of conditions created the perfect storm that led to it, with the society's increasing distrust in the international taxation system, growing awareness and condemnation over MNEs minimal global tax burden and rising critique towards the lack of action against MNEs tax avoidance and evasion strategies.

10. The BEPS Project removed the cloak over BEPS, its actions and results, revealing a global pandemic that undermines the international taxation system by ridding countries out of business profits to tax, shifting them from high-taxation to low-taxation countries.

11. BEPS exists in both developed and developing countries, denouncing its lack of allegiance and global reach.

12. The accumulated distrust and uproar over MNEs' minimal tax burden, created an exacerbated moral movement in taxation, potentially detrimental to the international taxation system as a whole, as it affects a person's right to lawful tax planning strategies, which should not cease to exist, the focus should be instead on unlawful and artificial strategies.

13. The BEPS Project pursued a holistic reform for the international taxation system, creating a relevant precedent.

14. Although it could have done more, *e.g.*, on minimum standards, overall, this project should be regarded as a success and it has become an international taxation landmark, bringing greater substance, transparency and equity to the international taxation system based on a consensual approach and subject to intense scrutiny by stakeholders.

15. Despite its holistic approach, it was established from its inception that the BEPS Project would respect and complement the existing international taxation system's principles and standards, even if those should have been questioned and a dynamic approach followed, rather than a static reform in a constantly evolving global economy.

16. Action 7 was not deemed a minimum standard, mostly due to the lack of consensus around it, which justifies the lack of a holistic approach to the PE concept.

17. Action 7's scope was reduced to a particular set of BEPS practices that were found to be particularly worrisome, the splitting-up of contracts, the specific activity exemptions and fragmentation of activities, and the use of commissionaire arrangements and similar strategies, which fell short of what should be expected from this concept's reform vis-à-vis its issues.

18. Despite its limited scope, Action 7 still shook the PE concept's foundation and presented a significant overhaul, however, its outcome lacks balance regarding its objectives and the means to achieve them, with many revealing disproportionate measures that should have been more carefully assessed.

19. The BEPS strategies' common elements were identified in its various fronts, spanning from the leeway given by stakeholders to MNEs with their apathy to prevent and fight these strategies by updating this concept in line with the global economy, to a lack of notion over the benefits of common and concerted efforts, instead of unilateralism, tax competition and divergent country practices.

20. The blend of these factors allowed MNEs to thrive and develop complex and artificial BEPS strategies to elude PE status, thus reducing, or eliminating, source taxation and lessening their overall tax burden.

21. The BEPS Project delivered Action 7 within this context, to prevent the artificial avoidance of PE status and restore source taxation by nullifying MNEs' BEPS strategies.

22. Action 7's first solution can be an effective mechanism to stop and prevent the artificial avoidance of PE status through the splitting of contracts by introducing an anti-abuse provision on connected activities between closely related persons.

23. This provision would be more effective if it were to be directly included in article 5 (3) OECDMC's wording and not left at the will of the countries, still, its implementation will likely result in a substantial rise of project PEs and diminish BEPS practices.

24. Action 7's failure to produce a single and firm anti-splitting provision will be a cause of divergent country practice and the continuance of BEPS practices.

25. Action 7's second solution deployed a two-pronged strategy and embraced an economic approach to the specific activity exemptions.

26. This second solution brings a significant shift to the specific activity exemptions' interpretation by submitting all listed activities to the preparatory or auxiliary test, placing a significant hurdle for MNEs to surpass, many of which will not be able to.

27. In this context, the exemplificative list of activities' existence can be questioned, as its removal would more clearly convey the paradigm shift and avoid divergent interpretations or country practices.

28. This change of course shrouds tax administrations with increased power to actively seek out PEs in activities that were once shielded by this provision.

29. This solution clearly lowers the PE threshold, as it will be increasingly harder for persons to claim refuge in this provision's sanctuary, thus engorging the PE concept's scope.

30. It is imperative to assess a provision's spillover effects, particularly when granting tax administrations with excessive prerogatives that could hinder cross-border ventures, especially for smaller enterprises, and there has been little consideration for the spillover effects arising from this second solution.

31. Action 7 suffers from a paradoxical chronic illness, its inability to abstain from granting alternative solutions that belittle it, evidenced herein by allowing countries to maintain the interpretation that article 5 (4) (a) to (d) OECDMC automatically has a preparatory or auxiliary character.

32. Action 7 succeeded in providing the much needed and long-awaited guidance on the "preparatory" and "auxiliary" character.

33. The anti-fragmentation rule marks the second element of this two-pronged solution and it spearheads Action 7's stance on MNEs' BEPS practices by putting forward a unique solution that directly targets and annuls them.

34. This rule rescues the valour and purpose of the specific activity exemptions provision by taking a holistic approach over complementary activities executed by closely related enterprises that form a cohesive business operation to limit this provision's exploitation.

35. This provision's design steered away from what should have been its core concern, artificial and abusive practices, resulting in an uncontrolled provision

that can target legitimate structuring activities with an overly wide net in an already low PE threshold.

36. Anti-abuse provisions dedicated to artificial and abusive practices should have been inserted in this provision to refrain its ambitious reach and potentially damaging side-effects and spillovers.

37. Disputes between taxpayers and tax administrations ought to sore due to the distressing guidance shortage on the anti-fragmentation rule and its concepts.

38. The PE threshold will be overly low with the removal of the automatic preparatory or auxiliary character of some listed activities together with the addition of this unbarred anti-fragmentation rule.

39. Despite its shortcomings and the need to be revised, from an efficiency standpoint, this rule would be a success, as it would turn MNEs fragmentation BEPS practices useless and prevent the artificial avoidance of PE status.

40. Action 7's final solution focused on the DAPE and was built on a fallacious working assumption, that commissionaire arrangements are, by definition, artificial and abusive, without sufficient evidence and without acknowledging the sound and legitimate reasons to adopt such structures.

41. This third solution went beyond Action 7's scope as it targeted artificial and legitimate schemes without differentiating between them, resulting in a loose and disproportionate solution that should have been aimed at artificial avoidance.

42. MNEs commissionaire arrangements and similar strategies thrived mostly due to the interpretational disparity between Civil Law and Common Law countries over the binding requirement, on whether it is legal or economic.

43. LRDs operating based on flash title mechanisms should not have been excluded from Action 7, considering that their core purpose is to avoid PE status and that this scheme can easily be used to circumvent Action 7's solutions against commissionaire arrangements, even if it offers a minimal amount of profit to source taxation.

44. An anti-abuse provision must not be so easily surpassed by simple modifications to existing structures, instead of the catch-all solution, an alternative provision, based on a specific anti-abuse provision, to fight artificial commissionaire arrangements would be more effective.

45. This third solution executes a pincer movement on MNEs' BEPS strategies by employing both the traditional formal approach, built upon the binding element, and an economic approach that focus on the fulfilment of the concluded contract.

46. The agent's role in the negotiation and conclusion of contracts gains greater relevance under Action 7's solution.

47. The DAPE threshold would become substantially lower based on the proposed modifications, theoretically satisfying Action 7's purpose, however, the result can hardly be deemed to be a success, being it an overbearing and disproportionate solution that dons a scope overly wide that can negatively affect the international taxation system and cross-border ventures.

48. Action 7's lack of guidance on this disproportionate solution will secure an increase in disputes between tax administrations and taxpayers, as the former will emerge with reinforced capabilities to tackle potential DAPE structures, whether or not they are tax-driven.

49. Tax administrations require, and should receive, strengthened prerogatives to target and eradicate artificial and abusive structures, however, their action needs to be limited to not hinder the global economy by unlawfully targeting legitimate and sound business structures.

50. This third solution appears to show that little to no consideration was given to the side-effects it could trigger, such as country resistance to implement an overbearing and disproportionate provision that attracts potentially limited benefits when compared with the burdens and loopholes it creates, and a disincentive to enter into cross-border ventures.

51. The proposed Article 5 (5) OECDMC sets a very low DAPE threshold and Action 7 proposes to set it even lower, by reducing article 5 (6) OECDMC's scope.

52. The independent agent status's solution should be praised as it salvages the "*bonafide*" agent concept and renders useless the MNEs' BEPS practices that exploited it through group and related enterprises.

53. The anti-abuse nature of this solution and the adamant presumptions included therein are essential for immunizing the independent agent status from BEPS group-related avoidance strategies, however, several answered topics, loose subjectivity, and a striking lack of guidance on new open concepts hinder this solution's potential successful path.

54. Considering the transversal relevance of the closely related concept, it should have been elevated to an independent position within article 5 OECDMC and granted additional guidance for its successful application and interpretation.

55. A dangerously low DAPE threshold emerges from the combined efforts of this final solution's elements, which ought to give rise to PEs and substantial disputes.

56. Despite the noteworthy solution for the independent agent status, it cannot salvage the overall DAPE solution from being detrimental and prejudicial, reason why it should be rethought and redrafted before implementation.

57. Although Action 7 is a unique venture, its solutions are not as unique, with many emerging from similar provisions within the UNMC or the continuous work from the OECD's working parties.

58. Even if imperfect in its outcome, Action 7 established a new PE concept standard without offending its core, and, in this regard, it should be regarded as a success.

59. However, on its solutions and their effects, Action 7 cannot be regarded as a success, rather a first sketch in need of plenty of revision, especially on side-effects and spillovers since just appealing to all facts and circumstances analysis does not suffice.

60. Action 7 failed to provide harmonious and consensual solutions to the PE concept's problems and the artificial avoidance of PE status.

61. The lack of guidance on new provisions and concepts and the unrestrained subjective approaches are appalling considering this report's relevance and its impact on the international taxation system.

62. This apathy paired with the increased burden placed on tax administrations and taxpayers regarding the PE status' assessment over the latter's cross-border activities will lead to a surge in disputes and litigation and will continuously hinder the international taxation system.

63. If taken at face value, Action 7's solutions could lead to an overbearing PE concept that hinders the global economy and the international taxation system, as it targets both sinners and saints.

64. Still, Action 7 presented solutions that will lower the PE threshold and that are mostly capable of nullifying MNEs' BEPS practices to artificial avoid PE status, and addressed some of article 5 2014 OECDMC's identified issues.

65. Lowering the PE threshold to successfully prevent artificial avoidance, increase the number of PEs and restore source taxation were among Action 7 and the BEPS Project's core objectives.

66. The low PE threshold goal was overshot by Action 7, resulting in a threshold set too low that could cause minimal cross-border endeavours to be deemed to have a PE, going against this concept's nature, as not every presence creates a taxable nexus, it requires a sufficient economic presence.

67. Although not a minimum standard, the PE concept is still crucial within the BEPS Project and the international taxation system, therefore Action 7 should not have been substandard.

68. We generally agree with most of Action 7's technical solutions, even if imperfect, but the loopholes and multiples paths are prejudicial.

69. Action 7 should have delivered consensus-based harmonious solutions and guidance to improve and update the existing international standards, hence its failure to achieve a sufficient compromise and consensus over firm solutions to fight and eradicate BEPS practices shall endure as one of its legacies, belittling its success and the partial merits of its proposals.

70. The uncertainty and disproportionality that arises from Action 7's solutions make it not eligible to fulfil its objectives, as it failed to adequately balance legal certainty and the prevention of tax avoidance through subjective rules.

71. Action 7's solutions are in dire need of profound revision and improvement.

CHAPTER 3

72. The MLI is a remarkable cutting-edge multilateral convention that resulted from unparalleled global political and academic support to a unique construction capable of delivering solutions to the BEPS malice in the international taxation system promptly, consistently, and harmoniously on over 3500 DTTs without cumbersome multiple domestic implementation processes.

73. The BEPS Project's success hinges on the implementation of its solutions and the MLI was the vessel designed for it.

74. The international community has been embracing the MLI and Action 7's solutions have begun to apply, with the MLI standing side-by-side with CTAs, instead of replacing them, in a unique relationship within the international taxation system with an apparent harmonious coexistence, despite the MLI's prevalence.

75. The MLI is a notorious aftershock to the BEPS Project for its multilateral approach to the DTT network.

76. Countries and the BEPS Project had to compromise for the MLI to exist, which prompted an overly complex multilateral convention that depends on a fragile "matching" system, based on options and alternatives elected by signatories/parties through notification processes, to produce its effects.

77. The MLI's effectiveness and success are questioned due to the myriad of features that need to be aligned so that a CTA's PE provision can be modified per Action 7.

78. The MLI may be a remarkable Trojan horse for added artificial avoidance due to its patchy delivery system derived from its vast flexibility, which became its downfall rather than an achievement, especially on PE-related provisions.

79. The MLI adds an extra layer of rules to the international taxation system due to its relationship with CTAs, where it does not revoke the CTAs' PE provisions, instead, it modifies their application or supersedes them, as it applies alongside CTAs.

80. The MLI is not a straightforward legal instrument that can be easily analysed and interpreted, it dons vague and subjective elements that harm legal certainty.

81. The MLI is a colossal cutting-edge legal instrument that triumphed in confirming that a global forum based on country equality and a sort of multilateral instrument for tax reform are possible, however, its success should have gone beyond its form and produce noteworthy substance on the PE concept.

82. As a first relevant draft, the MLI accomplished proof of concept and displays ample room for development to achieve the projected result.

83. As the MLI is already in force, the profound modifications it greatly requires can hardly be achieved, as substantial support from all parties would be required.

84. Stakeholders should learn from the MLI's mistakes and shortcomings and build a platform on top of which a new multilateral instrument for international tax

reform can be created to achieve greater certainty and consistency for the international taxation system.

85. Global commitment and consensus over the international taxation system's reform are essential to achieve worldwide harmonious success.

86. The MLI succeeded in adequately translating Action 7's solutions to its articles, without distorting their meaning or wording, merely adjusting cross-referencing and terminology.

87. Thus far, due to the countries' inaction and extensive reservations to part IV, the MLI has not satisfactorily enforced Action 7's solutions in CTAs across the DTT network.

88. As the MLI blindly adopted Action 7, its measures mostly intensify the concerns raised on the latter regarding the uncoordinated and inharmonious implementation of imperfect solutions.

89. The MLI's design has proven its inadequacy to carry out the BEPS Project's objective of coordinated and synchronised implementation of Action 7's solutions.

90. From the MLI, more was expected than just an overly complex vessel with a very questionable ability to effectively implement solutions, especially those connected with the PE concept, it should be more than a cartridge to deliver solutions.

91. The MLI should have reviewed and improved Action 7's solutions based on the stakeholders' contributions to better fight the artificial avoidance of PE status.

92. The MLI might just be an overstated secure glass casing used to hold the BEPS Project's Fabergé eggs and display them to qualifying and "matched" visitors, regardless of Action 7's egg's fragility or damages.

93. WP1's work should have been more detailed and be extended to all MLI provisions and not be limited to article 14 MLI.

94. As a blunt vessel for implementation of approved measures, the MLI could be a success, as a heightened mean to improve the international taxation system that previously ponders the ramifications of the successful implementation of its provisions, it cannot be deemed a success.

95. The international community's current state of commitment towards the MLI's PE provisions is far from ideal.

96. The MLI's early years' results are a daunting vision, as they mirror the countries' approval of this path and willingness to jointly update the PE concept.

CHAPTER 4

97. The OECDMC is a well-renowned key element of the international taxation system and updating it in harmony with the BEPS Project and the MLI was a natural and necessary aftereffect to achieve the BEPS Project's objectives and complement the DTT-related measures' implementation efforts, of which article 5 OECDMC's update is a corollary.

98. The OECD, although frailly, secured the opportunity presented to review and improve aspects of the PE concept that required attention and that were not addressed by Action 7.

99. The commendable work rendered on the PE concept's "at the disposal" element evidences the additional work conducted to improve this concept and that should have been conducted throughout article 5 OECDMC.

100. This work successfully clarified an important aspect of the physical and project PE, contributing to less divergent interpretations and disputes, and increased legal certainty.

101. Regardless, the OECD was still shy to address this concept's already identified concerns and to take bolder action.

102. Also, it is astonishing that the OECD failed to improve Action 7's lack of guidance and that its update took almost the same route as the latter's solutions, from the OECD, more was required than the mere replication of Action 7 and the MLI.

103. The OECD must address the stakeholders' concerns and review its provisions in accordance, some require additional guidance and others substantial redrafting and awareness over spillover effects.

104. The OECD's general lethargy on the OECDMC's 2017 update does not harm some of its solutions' valour, such as article 5 (8) 2017 OECDMC or the anti-splitting rule.

105. Against BEPS Project's purpose, countries are taking unilateral action to address the PE concept's loopholes and mismatches and the artificial avoidance of PE status through anti-abuse measures.

106. It is important to question what was the OECD's actual objective for the 2017 update, specifically if it was to effectively enhance the PE concept preparing it for the current global economy and prevent artificial avoidance practices, or to mindlessly transpose Action 7's solutions without critically judging them and their effects while maintaining most of past issues unaltered.

107. The 2017 update exhibits a blunt disregard for the stakeholders' concerns regarding side-effects and spillovers, revealing a perception deficit over the practical outcomes upon implementation.

108. The PE concept should not be the sacrificial lamb for the BEPS Project's goal of swift and coherent implementation of its DTT-related measures across the DTT network.

109. Action 7 shook the PE concept with significant changes to immunize it against artificial avoidance, and the MLI and the 2017 OECDMC followed Action 7's initial quake by replicating its treatment with little to no change.

110. Countries have been erratic regarding their positions on the PE concept, as their vast majority have not enacted reservations in the 2017 OECDMC and, in the MLI, roughly 50% of the parties reserved their right not to apply part, or all, of part IV; which suggests that countries prefer to bilaterally renegotiate DTTs than embrace the MLI's multilateralism-ish method.

111. Within article 5 2017 OECDMC's scarce reservations, the DAPE concept's provisions stand out as the ones least welcomed.

112. With few countries making reservations on the 2017 OECDMC's PE concept, the BEPS Project's success in preventing the artificial avoidance of PE status appears less dire.

113. Pursuing the bilateral renegotiation approach will surely give rise to divergent country practices which create opportunities for MNEs to explore and to continue executing current, and novel, BEPS strategies.

CHAPTER 5

114. Until 2021, Portugal's PE concept failed to accompany the international taxation system's quakes and evolution, however, thenceforth it broke from its inertia and

abandoned its pre-BEPS domestic PE concept through the 2021 Portuguese State Budget.

115. Portugal's lethargy in this regard was unsettling given its role in the BEPS Project.

116. The Portuguese DTT network generally follows closely the PE concept's OECDMC pre-BEPS version.

117. Portugal's latest DTT, with Angola, is already mostly compliant with the BEPS Project and the MLI on the PE concept.

118. All Portuguese DTTs were notified to the MLI Depository as CTAs, except for the Portugal-Angola DTT, denoting a significant commitment to the MLI.

119. However, Portugal's commitment on the MLI's PE concept is far inferior, as only two of part IV's provisions have a chance of affecting its CTAs, the anti-fragmentation rule and the closely related concept.

120. Portugal's traditional standpoint towards the PE concept, in DTTs and domestically, makes it highly prone to exploitation by MNEs, making Portugal's lack of effective commitment to the MLI on the prevention of the artificial avoidance of PE status appalling.

121. The 2021 Portuguese State Budget brought the domestic PE concept's much-expected reform, influenced by both the OECDMC and the UNMC.

122. With the wheels of change in motion on Portugal's PE concept, bilateral renegotiations of its DTT network ought to commence, ideally with a more adamant stance than the one taken on the MLI's PE concept.

123. Portugal appears to be steering its PE concept position towards the UNMC, parting from its traditional alignment with the OECDMC.

124. This unexpectedly paradigm shift is shocking and can mislead interpreters and courts, which have been relying upon the OECDMC and its Commentary to interpret and apply Portugal's PE concept.

125. The disparity in Portugal's stances on the PE concept is baffling, with significant divergences between them and no identifiable strategic pattern, just an apparent minimum standard, the anti-fragmentation rule and the closely related concept.

126. Portugal was dormant on the prevention of the artificial avoidance of PE status, however, it attempted to recover its place at the PE concept's vanguard through the domestic PE's reform, by implementing some of Action 7's solutions and lowering its threshold to nullify existing strategies by erasing existing loopholes

and mismatches, thus strengthening its domestic taxation and recouping source taxation.

127. This reform should have embraced the stakeholders' alerts and concerns and should have been preceded by a strenuous analysis of the provisions and their strategic implementation.

128. It is paramount for Portugal to employ cutting-edge modifications to upgrade this concept's reform before nefarious effects arise from its ill-conceived outcome.

CHAPTER 6

129. The PE concept's issues that remain forgotten in time and have not yet been resolved continue to hamper it and must therefore be addressed to fast-forward this concept into the current global reality.

130. We propose objective thresholds based on time and gross revenue to improve the PE concept and address some of the issues prone to concerns.

131. Our alternatives would provide taxpayers and tax administrations with certainty and reduce compliance and administration costs.

132. Objective thresholds work also as a booster for smaller companies' internationalization and expansion, as the initial taxation/administrative burdens/deterrents would be removed.

133. Growth comes as a corollary of fostering expansion and internationalization, and so smaller companies ought to evolve and eventually surpass the objective thresholds, thus potentially reaching PE status and triggering source taxation.

134. Greater rationality and efficiency also arise from implementing objective thresholds, as smaller cross-border ventures generating less tax revenue would be excluded from local compliance obligations, thus tax administrations would not have costs with their assessment, especially since these costs often supplant the tax effectively collected from such minor endeavours.

135. Article 5 (2) and (4) OECDMC should include fresher examples of PEs and of contemporary activities that generally have a preparatory or auxiliary character.

136. These provisions should also be expressly expanded to include examples and activities typical of the DAPE concept.

137. A definitive position on the link between article 5 (5) and (6) OECDMC must be achieved, and we find that the integration theory is the one that best reflects this provision's true connection, thus it should be foreseen in the OECDMC's Commentary.

138. Our vision for the PE concept's future lies on a stern rift between the digital and the traditional economy, preserving the nature, purpose and objectives of the PE concept without distorting or transfiguring it to a stage where it loses its essence.

139. Each reality must have a solution tailored to its unique particularities.

140. The traditional economy has the PE concept, and the digital and dematerialized economy should have a bespoke nexus instrument that bestows taxing rights upon relevant countries or that taxes that sector's business activities in the relevant country.

141. The PE concept's future path should focus on the fight against abuse and artificial avoidance and not on a mutation into a hybrid instrument.

142. Attempting to succeed in the digital and non-digital economy through a transfigured PE concept based on its current valour could prove to be disastrous, as it is not guaranteed that the PE concept will perform just as well in the digital economy and its success in the traditional economy could be diminished due to the modifications.

143. Physical presence lies at the nucleus of the PE concept's design and founding principles, so it is inapt for the digital and dematerialized economy, therefore a better nexus and taxation concept needs to be designed for the constantly evolving digital economy.

144. The PE concept shall resemble a primordial tree that despite quakes, revolutions, and plagues, if taken care of and nurtured, shall continue to bear fruit for times to come.

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