



Australian
National
University

International Tax
Design for the
21st Century

POLICY BRIEF 7/2021

Permanent Establishment Status

December 2021

Produced by

Tax Group

Melbourne Law School

Tax and Transfer Policy Institute

Crawford School of Public Policy

Hosted by

**Melbourne School
of Government**

Claritta Lee

Research Assistant, Melbourne Law School
The University of Melbourne

Daniel Minutillo

Research Fellow, Melbourne Law School
Teaching Fellow, Faculty of Business and Economics
The University of Melbourne

Miranda Stewart

Professor, Melbourne Law School
The University of Melbourne
Honorary Professor, Crawford School of Public Policy
The Australian National University

About this Policy Brief Series

This Policy Brief was produced as part of Discovery Project DP170104244, *Are tax base erosion and profit shifting countermeasures effective?* Australian National University and Melbourne University, funded by the Australian Research Council (Chief Investigators Alfred Tran and Miranda Stewart). This policy brief series is hosted by the Melbourne School of Government as part of its *Regulation and Design* research stream.

Tax Group
Melbourne Law School

The University of Melbourne
Parkville VIC 3010 Australia
www.unimelb.edu.au
CRICOS Provider No. 00116K

Tax and Transfer Policy Institute
Crawford School of Public Policy

The Australian National University
Acton ACT 2601 Australia
www.anu.edu.au
CRICOS Provider No. 00120C

Melbourne School of
Government

The University of Melbourne
Parkville VIC 3010 Australia
www.unimelb.edu.au
CRICOS Provider No. 00120C

Summary

This policy brief makes the following key points:

- International tax law establishes jurisdiction of a country over the business profits of a foreign enterprise with a sufficient nexus to the country through the concept of Permanent Establishment (**PE**). The long-standing definition of PE in most country tax laws and in tax treaties generally requires a physical presence or a fixed place of business in the jurisdiction.
- Multinational Enterprises (**MNEs**) can structure their global activities to avoid establishing a taxable PE in a market jurisdiction despite generating income there. The G20/OECD Base Erosion and Profit Shifting (**BEPS**) Project is an international initiative intended to strengthen the international tax system through the adoption of a 15 point plan and the 2021 Pillar One and Pillar Two consensus proposals. BEPS Action 7 recommends reforms to tax treaties to address PE avoidance strategies that avoid a country's tax jurisdiction. These tax strategies include commissionaire arrangements, taking advantage of specific activity exemptions in the definition, and contract splitting.
- The Action 7 recommendations are not a minimum standard and so are not mandatory for member states in the Inclusive Framework on BEPS. States can implement the Action 7 recommendations in their bilateral treaties by ratifying the Multilateral Instrument (MLI) and adopting Article 12 (commissionaire arrangement), Article 13 (anti-fragmentation rule), Article 14 (contract splitting) and Article 15 (related entities).
- Some countries have adopted MLI Articles 12-15 but many countries have adopted only some Articles, or made reservations to the MLI. Australia has adopted the Articles of the MLI but has reserved its right not to apply Article 12 in full and has adopted Article 13 and 14 subject to reservations to preserve its source right to tax natural resources.
- The digitalisation of the global economy makes it easier for a foreign business to sell goods or services into a jurisdiction without a physical presence. BEPS Action 7 does not directly address the broader challenge of taxing sales by global MNEs in the digitalised economy. Many countries have taken unilateral steps to levy tax on digital sales in their jurisdiction, for example through a Digital Services Tax, as introduced by France, or an expanded definition of PE or significant economic presence, as enacted by India.
- To provide a multilateral solution for taxing the global digital economy under BEPS Action 1, and to stop the spread of unilateral measures, the Inclusive Framework adopted the Two-Pillar Solution in October 2021 (Policy Brief 16/2021). Pillar One allocates a taxing right to the market jurisdiction for a share of excess global profits arising from sales there. However, Pillar One does not take further steps to extend the concept of PE for most businesses. The issue of nexus in the digitalised economy remains a challenge to the international tax system.

Introduction

International tax law establishes tax jurisdiction of a country over the profits of a foreign enterprise with a sufficient nexus to the country. The concept of Permanent Establishment (**PE**) in the jurisdiction is applied to establish the tax nexus in most country tax laws and bilateral tax treaties entered into between countries. Multinational Enterprises (**MNEs**) can structure their global activities to avoid establishing a taxable PE in a market jurisdiction despite generating income there.

The G20/OECD Base Erosion and Profit Shifting (**BEPS**) Project is an international initiative intended to strengthen the international tax system through the adoption of a 15 point plan and the 2021 Two-Pillar solution. This policy brief discusses BEPS Action 7 on Preventing the Artificial Avoidance of Permanent Establishment Status. The Action 7 Final Report recommended changes to update tax treaties and to address tax strategies to circumvent the PE definition, including commissionaire arrangements, taking advantage of specific activity exemptions in the definition, and contract splitting.

This brief first explains the PE avoidance issues that Action 7 aims to address and summarises the recommendations in the Final Report released in 2015. It explains how the recommendations are implemented in the Multilateral Instrument (**MLI**) to update the PE definition in bilateral tax treaties around the world (Policy Brief 13/2021). It then examines the Australian response to Action 7 in the MLI and in unilateral legislative and administrative reforms. The brief then considers the impact of Action 7 and identifies some further challenges for Australia and other countries in future.

1 What is BEPS?

The G20 declared the era of bank secrecy over in 2009 and later called for action to strengthen international taxation standards. The OECD responded with a 15-point Action Plan to address taxation issues with digitalisation (Action 1); and reform the international tax system to bring cohesion (Actions 2-5), restore substance (Actions 6-10), improve transparency (Actions 11-14), and develop a multilateral instrument (Action 15). This launched the international project to prevent Base Erosion (or double non-taxation) and Profit Shifting from jurisdictions where profitable activities take place: the BEPS Project.

OECD working groups developed technical policy proposals (released October 2015), recommending updates to the model tax convention, OECD-issued guidance, and domestic policy. From November 2016, the Multilateral Instrument would update more than half of the world's bilateral tax agreements.

OECD/G20 BEPS project participation is now almost global with the launch of multiple global forums and the Inclusive Framework (now 141 jurisdictions), membership of which requires commitment to the BEPS four 'minimum standards'. Having broadly addressed its mandate to implement the proposed package, the Inclusive Framework delivered in October 2021 Pillar-One (on a new nexus approach) and Pillar-Two (on a minimum global tax) as consensus proposals to tackle the digitalising global economy.

2 Action 7: Preventing the Artificial Avoidance of Permanent Establishment Status

What is the issue?

Countries have widely adopted a definition of PE in their domestic law and in tax treaties, based on Article 5 of the OECD Model Tax Convention. The long-standing definition of PE requires a physical presence such as a fixed place of business in the jurisdiction. The details of the definition vary between countries and in different tax treaties but Article 5 of the OECD Model Tax Convention provides a definition of PE that has been widely adopted by States as the basis for the PE definition in their bilateral tax treaties.

The primary meaning of PE is set out in Article 5(1) as “a fixed place of business through which the business of an enterprise is wholly or partly carried on”. Article 5(2) includes a branch, place of management, office, factory, workshop, and mine or other place of extraction of natural resources, while Article 5(3) includes a building site or construction project that lasts more than 12 months. Specific activities that are exempted from the definition of PE are listed in Article 5(4). Many of these exemptions relate to the sale of goods into a jurisdiction by a foreign enterprise. Other elements of the PE definition address activities of independent or dependent agents on behalf of a foreign business (Article 5(5) and (6)) and state that a company does not automatically have PE status merely because another company in the same MNE group has a PE in a country (Article 5(7) and (8)).

These aspects of the PE definition are challenged by the digitalisation of the global economy which enables a foreign business to sell goods or services into a jurisdiction without a physical presence. Multinational Enterprises (**MNEs**) can structure their global activities to avoid establishing a taxable PE in a market jurisdiction despite generating income there. The Action 7 report observed that tax avoidance strategies have developed over time to circumvent the PE definition. The main strategies of concern are commissionaire arrangements; the abuse of specific activity exemptions and fragmentation of business activities; and contract splitting.

Commissionaire arrangements enable a person to sell products in a jurisdiction in his or her own name, on behalf of a foreign enterprise that owns the products. Under such an arrangement, foreign enterprises can avoid the application of Article 5(5) or (6) about agents, and can thereby sell products into the jurisdiction without having PE to which such sales may be attributed for tax purposes, despite the economic nexus which justifies a taxable presence. Commissionaire arrangements are a civil law concept and have been more common in the European Union or other civil law jurisdictions. Thus, commissionaire arrangements may not be a major concern for common law jurisdictions.

Another strategy of foreign enterprises selling into a market in a jurisdiction has been to rely upon specific activity exemptions listed in Article 5(4), for example “the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise”. At the time that this exemption was drafted, such activities were considered merely preparatory or auxiliary in nature. Today, these activities may correspond to core business activities of MNEs that digitally sell goods around the globe.

Foreign enterprises may also avoid a PE by fragmenting their operating business into a number of smaller operations, such that each part is considered as engaging merely in preparatory or auxiliary activities that would come within the exemption in Article 5(4). Another strategy is to split up contracts

between closely related enterprises, so that each contract does not exceed 12 months in duration, thereby avoiding the time threshold for a PE for construction operations.

What does the OECD Recommend?

The Action 7 Final Report proposed changes to the definition of PE in Article 5 of the OECD Model Tax Convention to address these PE avoidance strategies, and for Member States to take steps to modify the definition in their bilateral treaties. The recommendations were adopted in Article 5 of the OECD Model Convention (2017) and are summarised in Table 1.

Table 1

Issues/strategies used to avoid PE	Article in Model Tax Convention	Proposed changes in Action 7
Commissionaire Arrangement and Similar Strategies	Article 5(5) and 5(6)	To change the definition of PE which involves commissionaire arrangements such that, if an intermediary or agent intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, then that enterprise is deemed to have a taxable presence in that jurisdiction, unless the intermediary is performing these activities in the course of an independent business.
Specific Activity Exemptions	Article 5(4)	To restrict the scope of exceptions to the definition of PE so that foreign enterprises cannot exploit these exceptions by fragmenting cohesive operating businesses into several small operations.
Contract Splitting	Article 5(3)	To address construction site exceptions being used to circumvent the PE by splitting up contracts between closely related enterprises.

Commissionaire arrangements: Previous Article 5(5) of the OECD Model Convention relied on the formal conclusion of contracts in the name of the foreign enterprise as a condition for PE status. The updated version of Article 5(5) is broadened and deems a contract to have been concluded when the agent plays a principal role leading to the conclusion of the contract without material modification by the foreign enterprise. The Action 7 report also recommended updating Article 5(6) concerning independent agents to adopt a more rigorous approach. It will no longer deem a person to be an independent agent if that person acts exclusively for a foreign enterprise to which the person is closely related.

Specific activity exemptions: Article 5(4) is modified to ensure that the various listed activities, such as fixed place of business being used for storage, display or delivery of goods, or fixed place of business being used solely for the purpose of purchasing goods or collecting information, are only exempted from PE status if the overall activity of the fixed place of business is of a preparatory or auxiliary character. A new anti-fragmentation rule is also introduced to prevent foreign enterprises from taking advantage of the exemptions by fragmenting a cohesive operating business into a number of smaller operations.

Contract splitting: This is not addressed with a specific modification to the definition of PE. Instead, the Action 7 report recommended that the abuse of Article 5(3) could be addressed by applying the

Principal Purpose Test (**PPT**) about treaty abuse, recommended in BEPS Action 6 (Policy Brief 6/2021). To clarify this, the Action 7 report provided an example, added in the Commentary on the PPT.

An important related issue, once the nexus is established as a result of finding a PE is to identify the profits attributable to the PE in the relevant jurisdiction that is permitted to tax. This links to Action 8-10 on transfer pricing (Policy Brief 8/2021). The Action 7 report alluded to the need for additional guidance and clarification on profit allocation under Article 7 of the OECD Model Tax Convention as a result of the revised version of Article 5, as well as other work on transfer pricing in relation to intangibles, risk and capital of the enterprise.

After release of the BEPS Action 7 report, the OECD Committee on Fiscal Affairs issued two public discussion drafts on the definition of PE. The first Discussion Draft (7 July 2016) sought comments on issues concerning dependent agents including commissionaire arrangements and warehouses as a fixed place of business. The second Discussion Draft (22 June 2017) was prepared taking into account consultation on the first draft and included high-level general principles for profit allocation to a PE.

On 22 March 2018, the OECD released additional guidance on the attribution of profits to permanent establishments that sets out high-level general principles and provides guidance on a PE arising from Article 5(5) including commissionaire arrangement of selling goods, online advertising sales structures and procurement sales structures. The guidance also explains when a PE is created following the changes to Article 5(4) and gives an example of how profits are allocated to PE as a result of anti-fragmentation rule in Article 5(4.1).

3 How has the Action Been Implemented Globally?

The BEPS Action 7 recommendations were reflected in the 2017 OECD Model Tax Convention. To implement Action 7, countries have to update their existing bilateral treaties. This can be done through bilateral treaty negotiation (which is very slow) or by signing and ratifying the MLI which as developed in the BEPS project to modify bilateral treaties between participating countries in a speedy manner (Policy Brief 13/2021).

The Action 7 recommendations are not minimum standards of the MLI. This means that it is voluntary, though recommended, for members of the Inclusive Framework to adopt the changes. **Table 2** summarises the MLI Articles that address the Action 7 recommendations. For MLI Articles to be implemented with respect to tax treaties, both Contracting States have to apply the MLI and then both have to adopt the relevant MLI Article in an identical manner (where neither State makes a reservation). The relevant MLI Article will not take effect unless these two conditions are met.

Table 2

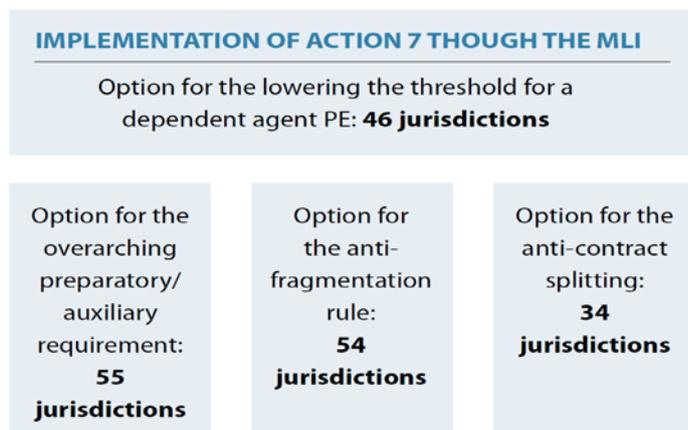
Issues/strategies used to avoid PE	Relevant Article Model Tax Convention	Corresponding MLI Article	Countries may choose to:
Commissionaire Arrangements and Similar Strategies	Article 5(5) and 5(6)	Article 12	<ul style="list-style-type: none"> • Adopt Article 12 without reservation; or • Not adopt Article 12 at all (Article 12(4)).
Specific Activity Exemptions	Article 5(4)	Article 13	<ul style="list-style-type: none"> • Adopt ‘preparatory or auxiliary character’ rule by choosing either or none of (Article 13(1)): <ul style="list-style-type: none"> ○ Option A (Article 13(2)): insert the requirement that all specific activity exemptions must be of preparatory or auxiliary character, or ○ Option B (Article 13(3)): insert the requirement for some but not all the specific activity exemptions must be of preparatory or auxiliary character • Adopt anti-fragmentation rule (Article 13(4)). • Not adopt the anti-fragmentation rule under Article 13(6)(c). • Not adopt Article 13 at all.
Contract Splitting	Article 5(3)	Article 14	<ul style="list-style-type: none"> • Adopt Article 14 without reservation; or • Not adopt Article 14 at all (Article 14(3)(a)); or • Adopt Article 14 but not with respect to bilateral treaty rules in relation to exploration for or exploitation of natural resources (Article 14(3)(b)).
Definition of a Person Closely Related to an Enterprise		Article 15	<ul style="list-style-type: none"> • Adopt Article 15 without reservation; or • Not adopt Article 15 at all depending on the adoption of Articles 12-14.

The OECD Progress Report July 2019 – July 2020, published data on how many jurisdictions have adopted the Articles for each BEPS Action. Specifically, the Progress Report identifies the number of jurisdictions that have deposited their instrument of ratification, acceptance and approval with the OECD and have actually incorporated the modified PE definitions in their bilateral tax treaties (subject to their counterparties’ agreement).

By July 2020, 46 jurisdictions opted for the modification of Article 5(5) and 5(6) of the Model Tax Convention which lowers the threshold for a dependent agent. This impacts a total of 339 treaties. The modification of Article 5(4) which contains the overarching preparatory and auxiliary requirement was adopted by 55 jurisdictions (379 treaties), while 54 jurisdictions opted for the anti-fragmentation

rule (542 treaties). Finally, at that date, 34 jurisdictions opted for the anti-contract splitting provision (163 treaties). Overall, out of 141 Inclusive Framework member countries, less than 40 per cent have opted for the revised PE definitions recommended in the Action 7 report. Figure 1 presents statistics on implementation of Action 7 as at July 2020.

Figure 1: Implementation of Action 7 in the MLI



The relatively low adoption of Action 7 recommendations and the decision not to make Action 7 a minimum standard in the MLI suggests that the Action 7 recommendations were not considered to be of central importance by members of the Inclusive Framework.

Some governments may also have addressed the issue in different ways, including through bilateral tax treaty negotiation or domestic anti-abuse legislation.

Source: [OECD/G20 Inclusive Framework on BEPS Progress Report July 2019 – July 2020](#)

Article 12 of the MLI about commissionaire arrangements has been adopted by many developing countries and by several developed countries. Countries that adopted the provision have in this way expanded their source taxing rights by expanding the definition of PE. This result was achieved in other ways in some countries, for example by a broad interpretation of the traditional definition of PE. In France, the administrative supreme court expanded the definition of PE in a case called *Conservant* in relation to the France-Ireland tax treaty ([Decision No. 420174](#)). The court found that a PE will exist in France if an agent has the power to negotiate the details and have impact on the conclusion of contracts for the foreign enterprise, even if the contracts are formally concluded outside of France.

Other jurisdictions opted out of Article 12 or adopted it with reservations. One reason was because of uncertainty surrounding the application of the test in practice. Many jurisdictions that opted out of Article 12 are known to be jurisdictions chosen by MNEs to incorporate holding companies in order to take advantage of a lower corporate tax ([Smith 2011](#); [Smith 2017](#)). In a low tax jurisdiction, an MNE can reduce its overall tax burden while that jurisdiction benefits from an increase in tax revenues which it would not otherwise have gained. Thus, there would be a low incentive for low-tax jurisdictions to adopt Article 12 ([Smith 2017](#)). There were also concerns that Article 12 fundamentally shifts the taxing right from residence to source jurisdictions ([International Fiscal Association 2020](#)). Some jurisdictions viewed their domestic anti-avoidance laws as sufficient to address commissionaire arrangements ([International Fiscal Association 2020](#)).

Regarding Article 13 on specific activity exemptions, a majority of countries chose either Option A or Option B and also applied anti-fragmentation rule. However, several countries opted out of Article 13 and took the position that the specific activity exemptions are inherently preparatory or auxiliary and it was therefore not necessary to satisfy these additional criteria ([International Fiscal Association 2020](#)). Many countries also opted out of Article 14 on contract splitting. Some opted out due to some concerns that the provisions could apply to legitimate business arrangements and suggested that problems of abusive transactions can be addressed by domestic anti-avoidance rules ([International Fiscal Association 2020](#)). Some countries that adopted Article 14 did not apply it for natural resource exploration and exploitation, including Australia.

4 How has Australia Implemented the Action?

Adoption in the MLI and tax treaties

Australia has adopted most of the Action 7 recommendations with some reservations. In general, the Australian position has been to adopt as many of the optional Articles in the MLI as possible and to use the MLI reservation system in only limited circumstances (as explained in the [Australian Treasury December 2016 Consultation Paper](#)). Consequently, Australia's initial proposal was to adopt Article 12 across all covered tax agreements without reservation; adopt Option A of Article 13 (subject to reservation permitted by Article 13(6)(b)) and the anti-fragmentation rule; adopt Article 14, subject to reservation permitted by Article 14(3)(b); and adopt Article 15. After consultation, the Australian Treasury determined that it would not adopt Article 12 on commissionaire arrangements and similar strategies.

To implement the OECD's recommended modifications to the PE definitions in the MLI, the MLI was passed into domestic law under [Treasury Laws Amendment \(OECD Multilateral Instrument\) Act 2018](#). On 26 September 2018, Australia deposited the instrument of ratification with the OECD and the MLI entered into force from 1 January 2019. By virtue of s 4(1) of the [International Tax Agreement Act 1953](#), the MLI has priority over domestic agreements. However, it is subject to the domestic general anti-avoidance rule and the [Multinational Anti-Avoidance Law \(MAAL\)](#).

Currently, Australia has three reservations with respect to Articles 12, 13 and 14. Although Australia made a reservation not to apply Article 12, Australia expressed that it would consider adopting the rule in future bilateral treaties. Australia's recent tax treaties with Germany (2015) and Israel (2019) both use the language of MLI Article 12 in their PE definition. Similar to the concerns expressed by other countries, Australia has also sought further clarification on the practical application of the effect of MLI Article 12 (or similar changes in bilateral treaties).

For Article 13, Australia chose Option A subject to the reservation in Article 13(6)(b) to insert the requirement that all the specific activity exemptions must be of preparatory or auxiliary character. The anti-fragmentation rule was adopted as well.

Australia also adopted Article 14 but pursuant to Article 14(3)(b), it reserves the right for Article 14 not to apply to provisions in its Covered Tax Agreements with respect to exploration for or exploitation of natural resources. This was based on Australia's experience that the Model Tax Convention was not adequate to deal with high value activities in the development of natural resources in offshore regions (Australian Parliament 2002). For example, it could be difficult to constitute a PE offshore when mobile equipment used during offshore exploration does not necessarily have geographical fixedness (Australian Parliament 2002). Thus, the reservation allows Australia to preserve its source right over mining resources. As for Article 15, Australia has adopted it without reservation.

Multinational Anti-Avoidance Law

Before the release of the BEPS Action 7 report, Australia took unilateral action to address the avoidance of PE status by MNEs selling goods or services into Australia, in the Multinational Anti-Avoidance Law (MAAL). The MAAL was introduced into Part IVA of the *Income Tax Assessment Act 1936* by [Tax Laws Amendment \(Combating Multinational Tax Avoidance\) Act 2015](#) on 11 December

2015. The MAAL extends Australia’s General Anti-Avoidance Rule (**GAAR**) in Part IVA and this reform also made amendments to the *Taxation Administration Act 1953*. This approach was a departure from the OECD’s recommended model solution.

The Australian Treasury takes the view that the MAAL contains a sufficiently expanded concept of PE where there is a main purpose of avoiding a PE for significant global entities. The MAAL is expected to continue to protect Australian tax revenue from tax avoidance arrangements based on ‘book offshore’ model. The Explanatory Memorandum to the Bill introducing the MAAL explains that this anti-abuse rule seeks to address the erosion of the Australian tax base by MNEs that use artificial arrangements to avoid the attribution of business profits through a PE, or taxable presence in Australia.

The MAAL applies to significant global entities with an annual income in excess of \$1 billion in a particular income year. Schemes captured by the MAAL will include those making supplies to an Australian customer, undertaking activities in Australia in connection with the supply and undertaking activities by an Australian entity that is commercially dependent on the foreign entity.

Administrative response

To assist in administering the MAAL, the Australian Taxation Office (**ATO**) has published Law Companion Ruling 2015/2 on schemes that limit taxable presence in Australia. The ATO has also released Tax Determination 2018/12 to clarify the meaning of some relevant terms.

On 25 May 2021, the ATO updated its guidance in relation to COVID-19 and permanent establishments, which applies until 31 December 2021. This was in response to overseas travel restrictions and foreign companies’ concerns that their employees being dislocated to jurisdictions other than their usual place of work and working from their homes could result in PE status in those other jurisdictions and change their tax obligations.

5 Impact

The BEPS Action 7 recommendations that expand in a limited way the definition of PE may increase the occasions where a PE will be found in the countries that have implemented it. Since Australia is typically considered a net capital importer (Jogarajan & Redenbach 2020), the expanded definition of PE will increase source taxation, which will likely be beneficial for Australia.

The OECD Multilateral Instrument Matching Database provides a summary of Australia’s counterparty positions in the MLI. As of 21 October 2021, none of Australia’s tax treaty partners have implemented Article 12. With respect to Article 13, 17 of Australia’s treaty partners have adopted Option A and 24 have adopted the anti-fragmentation rule (Article 13(4)). Article 14 applies to 13 tax treaties, either superseding the provisions in the agreement to the extent of the incompatibility, or not being applied with respect to the existing provisions relating to exploration for or exploitation of natural resources. For Article 15, 24 tax treaties to date have incorporated the updated definition.

Despite the additional guidance on the attribution of profits to PE, there are still areas that remain unclear. Tax authorities from different jurisdictions may have competing views, which can lead to different interpretations of the rules. Some jurisdictions are waiting, before signing the MLI, to see how the implementation practically operates in the countries that have adopted the provisions.

6 What comes next?

Action 7 has been adopted by a reasonable number of countries but there are still many countries that are yet to implement the Action 7 recommendations. Some countries are waiting to observe the practical operation of Action 7 from the countries that have implemented Articles 12-15 of the MLI. Further clarifications of its effect might increase the number of jurisdictions that will sign up to the Articles 12-15 in the MLI in future.

The digitalisation of the global economy makes it easier for a foreign business to sell goods or services into a jurisdiction without a physical presence. BEPS Action 7 does not directly address the broader challenge of taxing sales by global MNEs in the digitalised economy. Many countries have taken unilateral steps to levy tax on digital sales in their jurisdiction, for example through a Digital Services Tax, as introduced by France, or an expanded definition of PE or significant economic presence, as enacted by India.

The Inclusive Framework Two-Pillar Solution of October 2021 will take the Action 7 developments a step further. Pillar One, if it is implemented, will have the effect of updating PE and source rules for the digital age, for the largest global MNEs (see Policy Briefs 16 and 17/2021). Action 7 was a response to the traditional international tax system which relied on the physical presence of a business to establish jurisdiction to tax. In contrast, Pillar One will introduce a new system that will establish a new nexus approach for the market jurisdiction and apply a formulary approach to allocate jurisdiction to tax a proportion of excess profits of very large and profitable MNEs. Australia has engaged strongly in the Inclusive Framework and is likely to implement the Two-Pillar Solution in coming years.

Outside the limited scope of the Two-Pillar Solution, the concept of PE in international tax treaties remains largely tied to concepts of physical presence or a fixed place of business, despite the Action 7 reforms. The concept is likely to become increasingly outdated in a digitalised economy. Further tax policy work will need to be done to establish a stable, and sustainable solution to benefit all countries globally in future.

References

Australian Government (2016) 'Australia's adoption of the BEPS Convention (Multilateral Instrument): Consultation Paper'. Available here: https://treasury.gov.au/sites/default/files/2019-03/C2016-057_MLI_dcp.pdf, viewed 5 October 2021.

Australian Government Federal Register of Legislation (2021) 'Income Tax Assessment Act 1936'. Available here: https://www.legislation.gov.au/Details/C2021C00213/Html/Volume_3#_Toc71194535, viewed 26 October 2021.

Australian Government Federal Register of Legislation (2021) 'International Tax Agreements Act 1953'. Available here: <https://www.legislation.gov.au/Details/C2021C00295>, viewed 10 November 2021.

Australian Government Treasury (2018) 'Multilateral Instrument'. Available here: <https://treasury.gov.au/tax-treaties/multilateral-instrument>, viewed 5 October 2021.

Australian Government Federal Register of Legislation (2021) 'Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015'. Available here: <https://www.legislation.gov.au/Details/C2015A00170>, viewed 26 October 2021.

Australian Government Federal Register of Legislation (2021) 'Treasury Laws Amendment (OECD Multilateral Instrument) Act 2018'. Available here: <https://www.legislation.gov.au/Details/C2018A00083>, viewed 26 October 2021.

Australian Parliament (2002) 'International Tax Agreements Amendment Bill (No. 2) 2002'. Available here: https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bld=r1633, viewed 26 October 2021.

Australian Parliament (2015) 'Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015'. Available here: https://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r5549_ems_f2f9c061-45d9-4f1f-b8f9-eb140cdc08ae/upload_pdf/503830.pdf;fileType=application%2Fpdf, viewed 26 October 2021.

Australian Taxation Office (2015) 'Law Companion Ruling 2015/2'. Available here: <https://www.ato.gov.au/law/view/document?DocID=COG/LCR20152/NAT/ATO/00001&PiT=20180219000001>, viewed 19 October 2021.

Australian Taxation Office (2018) 'Taxation Determination 2018/12'. Available here: <https://www.ato.gov.au/law/view/document?docid=TXD/TD201812/NAT/ATO/00001>, viewed 19 October 2021.

Australian Taxation Office (2018) 'Taxation Ruling 2002/5'. Available here: <https://www.ato.gov.au/law/view/document?DocID=%22TXR%2FTR20025%2FNAT%2FATO%2F00001%22&PiT=20210512000001>, viewed 10 November 2021.

Australia Taxation Office (2021) 'COVID-19 and permanent establishments'. Available here: <https://www.ato.gov.au/Business/Business-bulletins-newsroom/International/COVID-19-and-permanent-establishments/>, viewed 15 November 2021.

Canava, JP (2017) 'Ireland's tax treaty position on the OECD multilateral instrument'. Available here: <https://mnetax.com/irelands-tax-treaty-position-oecd-multilateral-instrument-21797>, viewed 25 October 2021.

Conseil D'Etat (2020) 'Base de jurisprudence - Decision n° 420174'. Available here: <https://www.conseil-etat.fr/fr/arianeweb/CE/decision/2020-12-11/420174>, viewed 10 November 2021.

Deloitte (2015) 'BEPS Action 7: Preventing the artificial avoidance of Permanent Establishment ("PE") status'. Available here: <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-beps-action-7.pdf>, viewed 28 October 2021.

Epstein, P & Stack, R (2018) 'Additional guidance released on attribution of profits to PEs'. Available here: <https://www.taxathand.com/article/9582/Australia/2018/Additional-guidance-released-on-attribution-of-profits-to-PEs>, viewed 4 November 2021.

G20 (2009) 'London Summit – Leaders' Statement: 2 April 2009'. Available here: https://www.imf.org/external/np/sec/pr/2009/pdf/g20_040209.pdf, viewed 19 August 2021.

G20 (2013) 'Communique of Meeting of G20 Finance Ministers and Central Bank Governors: Moscow, February 16, 2013'. Available here: <http://www.g20.utoronto.ca/2013/2013-0216-finance.html>, viewed 19 August 2021.

OECD (2013) 'Action Plan on Base Erosion and Profit Shifting'. Available here: <https://www.oecd.org/ctp/BEPSActionPlan.pdf>, viewed 19 August 2021.

International Fiscal Association (2020) 'Cahiers de Droit Fiscal International Volume 105A: Reconstructing the Treaty Network; B: Exchange of information: issues, use and collaboration'. Available here: <https://www.ifa.nl/media/6223/ifacahierivol-105ab-summary.pdf>, viewed 4 November 2021.

Jogarajan, S & Redenbach, G (2020) 'Cahiers de Droit Fiscal International Volume 105A: Reconstructing the Treaty Network'. Available here: https://law.unimelb.edu.au/data/assets/pdf_file/0008/3525425/IFA-National-Report.pdf, viewed 4 November 2021.

Jones Day (2021) 'France Expanding Tax Permanent Establishment Definition, Overturning Previous Case Law'. Available here: <https://www.jonesday.com/en/insights/2021/03/france-expanding-tax-permanent-establishment-definition>, viewed 10 November 2021.

Lebas, Emilien (2017) 'Artificial avoidance of permanent establishment status'. Available here: <https://home.kpmg/xx/en/home/insights/2017/02/artificial-avoidance-of-permanent-establishment-status.html>, viewed 4 November 2021.

Maucour, C, Benchetrit, J, Gasne Stéphane (2021) 'International project management: Permanent establishments in ambush'. Available here: <https://www.internationaltaxreview.com/article/b1r2trc1c1y1fm/international-project-management-permanent-establishments-in-ambush>, viewed 10 November 2021.

OECD (2015) 'BEPS 2015 Final Reports'. Available here: <https://www.oecd.org/ctp/beps-2015-final-reports.htm>, viewed 19 August 2021.

OECD (2015) 'Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report'. Available here: <https://www.oecd-ilibrary.org/docserver/9789264241220-en.pdf?expires=1635311312&id=id&accname=guest&checksum=967F5FD30E1420BCB1ADB0F8A981FD3B>, viewed 4 October 2021.

OECD (2016) 'Release of BEPS discussion drafts on attribution of profits to permanent establishments and revised guidance on profit splits'. Available here: <https://www.oecd.org/tax/transfer-pricing/release-of-beps-discussion-drafts-on-attribution-of-profits-to-permanent-establishments-and-revised-guidance-on-profit-splits.htm>, viewed 19 October 2021.

OECD (2017) 'Action 7 Permanent establishment status'. Available here: <https://www.oecd.org/tax/beps/beps-actions/action7/>, viewed 4 October 2021.

OECD (2017) 'Australia - Status of List of Reservations and Notifications at the Time of Signature'. Available here: <https://www.oecd.org/tax/treaties/beps-mli-position-australia.pdf>, viewed 5 October 2021.

OECD (2017) 'Model Tax Convention on Income and on Capital: Condensed Version 2017'. Available here: <https://www.oecd.org/ctp/treaties/model-tax-convention-on-income-and-on-capital-condensed-version-20745419.htm>, viewed 19 August 2021.

OECD (2017) 'OECD releases BEPS discussion drafts on attribution of profits to permanent establishments and transactional profit splits'. Available here: <https://www.oecd.org/tax/transfer-pricing/oecd-releases-beps-discussion-drafts-on-attribution-of-profits-to-permanent-establishments-and-transactional-profit-splits.htm>, viewed 19 October 2021.

OECD (2017) 'OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017'. Available here: <https://www.oecd.org/tax/transfer-pricing/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-20769717.htm>, viewed 19 August 2021.

OECD (2016) 'Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS'. Available here: <https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm>, viewed 19 August 2021.

OECD (2018) 'Additional Guidance on the Attribution of Profits to a Permanent Establishment under BEPS Action 7'. Available here: <https://www.oecd.org/tax/beps/additional-guidance-attribution-of-profits-to-a-permanent-establishment-under-beps-action7.htm>, viewed 19 October 2021.

OECD (2019) 'Model Tax Convention on Income and on Capital 2017 (Full Version)'. Available here: <https://www.oecd.org/tax/model-tax-convention-on-income-and-on-capital-full-version-9a5b369e-en.htm>, viewed 19 October 2021.

OECD (2020) 'OECD/G20 Inclusive Framework on BEPS Progress report July 2019 – July 2020'. Available here: <https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-progress-report-july-2019-july-2020.pdf>, viewed 5 October 2021.

OECD (2021) 'MLI Matching Database (beta)'. Available here: <https://www.oecd.org/tax/treaties/mli-matching-database.htm>, viewed 10 November 2021.

OECD (2021) 'Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy – 1 July 2021'. Available here: <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>, viewed 19 August 2021.

OECD (2021) 'Updated guidance on tax treaties and the impact of the COVID-19 pandemic'. Available here: <https://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/#section-d1e140>, viewed 15 November 2021.

OECD/Inclusive Framework on BEPS (2020) 'Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint'. Available here: <https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint-beba0634-en.htm>, viewed 19 August 2021.

OECD/Inclusive Framework on BEPS (2020) 'Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint'. Available here: <https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-two-blueprint-abb4c3d1-en.htm>, viewed 19 August 2021.

Oguttu, AW (2018) 'Should Developing Countries Sign the OECD Multilateral Instrument to Address Treaty Related Base Erosion and Profit Shifting Measures?'. Available here: <https://www.cgdev.org/sites/default/files/should-developing-countries-sign-oecd-multilateral-instrument-address-treaty-related.pdf>, viewed 10 November 2021.

PwC (2016) 'Unilateral 'Anti-Avoidance' Action as a precursor to the BEPS recommendations - UK and Australian perspectives'. Available here: <https://www.pwc.com/au/tax/taxtalk/assets/alerts/australia-unilateral-anti-avoidance-14oct16.pdf>, viewed 5 November 2021.

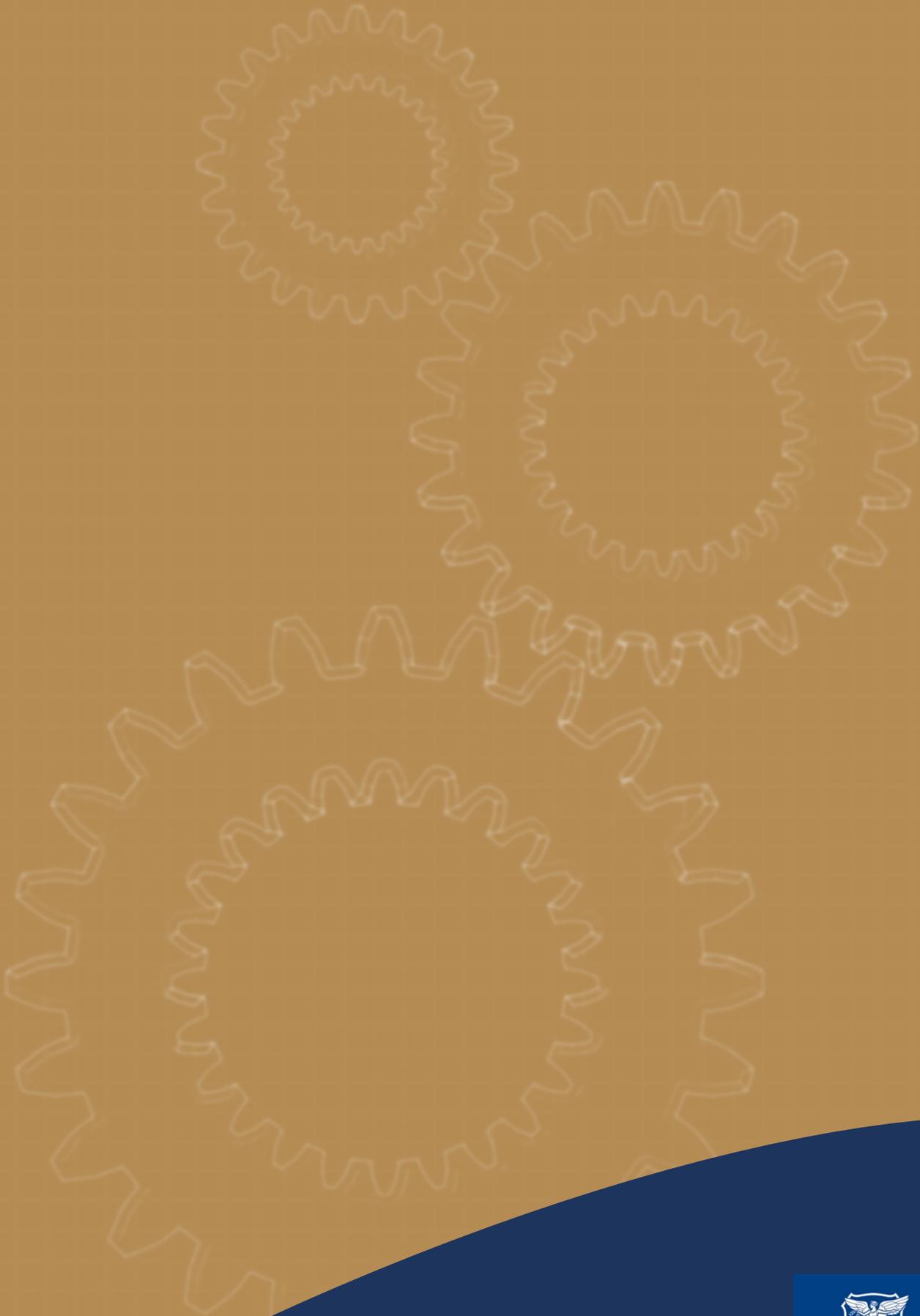
PwC (2020) 'Unexpected taxing rights may result from changes to PE threshold aimed at artificial fragmentation'. Available here: <https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-unexpected-taxing-rights-may-result-from-changes-to-pe-threshold-feb.pdf>, viewed 5 November 2021.

Smith, L (2017) 'The Efficacy of the MLI in Europe'. Available here: <http://www.mjilonline.org/the-efficacy-of-the-mli-in-europe/>, viewed 2021.

Smith, P (2011) 'Comparative analysis of European holding company jurisdictions'. Available here: <https://www.taxjournal.com/articles/comparative-analysis-tax-jurisdictions>, viewed 6 October 2021.

Tietjen, C & Owen, R (2010) 'The revival of the commissionaire'. Available here: <https://www.taxjournal.com/articles/revival-commissionaire>, viewed 10 November 2021.

Vergnat, A & Desmonts, R (2020) 'Supreme Tax Court Upholds Broad Interpretation of Permanent Establishment, Partially Overturns Protective Google Case Precedents on Dependent Agents'. Available here: <https://www.natlawreview.com/article/supreme-tax-court-upholds-broad-interpretation-permanent-establishment-partially>, viewed 28 November 2021.



Australian
National
University



THE UNIVERSITY OF
MELBOURNE