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Beyond Artificial Avoidance: The Limits of BEPS Action 7 and the Agency Permanent Establishment Rule under Article 5 OECD in the Digital Economy

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Abstract (English)

This thesis focuses on analysing whether the revised agency permanent establishment rule introduced by BEPS Action 7 effectively prevents the artificial avoidance of permanent establishment status in digital and platform-based business models, or whether the digital economy requires a complementary nexus standard beyond Article 5 of the OECD Model Tax Convention. The study uses a doctrinal legal research approach, supplemented by a limited comparative analysis between the OECD and UN Model Conventions, where the legal framework governing the taxation of cross-border business profits is examined through treaty provisions, OECD Commentary, case law, and academic literature to establish how the permanent establishment threshold operates in relation to digitalized business activity. The findings of this research indicate that, while the revised principal-role test and the narrowed independent-agent exception succeed against traditional commissionaire arrangements such as those upheld in *Zimmer* and *Philip Morris*, they leave the underlying architecture of the agency rule intact: the agency permanent establishment still presupposes an identifiable person, acting in the source state, whose conduct is the proximate cause of the conclusion of contracts. As a result, it struggles to capture the economic presence of highly digitalised and platform-based enterprises whose business activities are conducted through automated systems, algorithms, data exploitation, and user participation rather than through dependent agents. Special emphasis is placed on the alternative responses to this gap, namely the significant economic and digital presence proposals and the UN Model's Article 12B on automated digital services, which are shown to operate alongside Article 5 rather than repairing it, thereby confirming that the difficulty is one of nexus rather than agency. The thesis concludes that while BEPS Action 7 constitutes an important improvement in combating the artificial avoidance of PE status, it does not fully resolve the broader nexus challenges created by the digital economy. Consequently, a complementary nexus standard based on significant economic or digital presence appears necessary to ensure a more coherent allocation of taxing rights and to better align taxation with value creation in the modern digitalised economy.

Abstract (Deutsch)

Diese Arbeit befasst sich mit der Frage, ob die durch BEPS Action 7 reformierte Vertreterbetriebsstättenregel die künstliche Umgehung des Betriebsstättenstatus bei digitalen und plattformbasierten Geschäftsmodellen wirksam verhindert, oder ob die digitale Wirtschaft einen ergänzenden Anknüpfungsstandard jenseits von Article 5 des OECD-Musterabkommens erfordert. Die Untersuchung folgt einem rechtsdogmatischen Forschungsansatz, ergänzt durch eine begrenzte rechtsvergleichende Analyse zwischen dem OECD- und dem UN-Musterabkommen, wobei der rechtliche Rahmen für die Besteuerung grenzüberschreitender Unternehmensgewinne anhand von Abkommensbestimmungen, dem OECD-Kommentar, der Rechtsprechung und der Fachliteratur untersucht wird, um aufzuzeigen, wie die Betriebsstättenschwelle im Verhältnis zu digitalisierter Geschäftstätigkeit funktioniert. Die Ergebnisse dieser Untersuchung zeigen, dass der reformierte „principal role"-Test sowie die eingeschränkte Ausnahme für unabhängige Vertreter zwar gegen herkömmliche Kommissionärsstrukturen wirken, wie sie in den Fällen *Zimmer* und *Philip Morris* bestätigt wurden, dabei jedoch die grundlegende Architektur der Vertreterregel unangetastet lassen: Die Vertreterbetriebsstätte setzt nach wie vor eine identifizierbare Person voraus, die im Quellenstaat handelt und deren Verhalten die unmittelbare Ursache für den Abschluss von Verträgen bildet. Infolgedessen gelingt es ihr nur schwer, die wirtschaftliche Präsenz hochgradig digitalisierter und plattformbasierter Unternehmen zu erfassen, deren Geschäftstätigkeit über automatisierte Systeme, Algorithmen, Datennutzung und Nutzerbeteiligung statt über abhängige Vertreter ausgeübt wird. Besondere Aufmerksamkeit gilt den alternativen Antworten auf diese Lücke, namentlich den Vorschlägen zur signifikanten wirtschaftlichen und digitalen Präsenz sowie Article 12B des UN-Musterabkommens über automatisierte digitale Dienstleistungen, von denen sich zeigt, dass sie neben Article 5 wirken, anstatt ihn zu reparieren, was bestätigt, dass es sich um ein Problem der Anknüpfung (Nexus) und nicht der Vertretung handelt. Die Arbeit kommt zu dem Schluss, dass BEPS Action 7 zwar eine wichtige Verbesserung bei der Bekämpfung der künstlichen Umgehung des Betriebsstättenstatus darstellt, die umfassenderen Anknüpfungsprobleme der digitalen Wirtschaft jedoch nicht vollständig löst. Folglich erscheint ein ergänzender Anknüpfungsstandard auf der Grundlage einer signifikanten wirtschaftlichen oder digitalen Präsenz erforderlich, um eine kohärentere Zuteilung der Besteuerungsrechte zu gewährleisten und die Besteuerung besser an der Wertschöpfung in der modernen digitalisierten Wirtschaft auszurichten.

TABLE OF CONTENTS

1. INTRODUCTION

The advent of the digital economy and the internationalization of trade over the past three decades have revealed an increasing discrepancy at the core of the global tax system: the gap between the taxations of corporate profits and where economic value is created.[1] The traditional regulations governing cross-border business taxation were created for a world where businesses operating in foreign markets were practically required to be physically present there and where economic activity was anchored to physical locations, such as factories, offices, and warehouses.[2] That world has undergone a significant transformation, but it has not vanished. Some of the biggest businesses in the world today make billions of dollars from market jurisdictions while having little to no significant physical presence there.[3] One of the main problems with international tax policy in the digital age, according to the OECD, is the structural misalignment between the countries where earnings are made and those where they are taxed.[4]

The concept of permanent establishment (PE), which functions in bilateral tax treaties as the threshold that must be crossed before a source state gets the ability to tax a foreign enterprise's economic profits, is the doctrinal mechanism most directly impacted by this discrepancy.[5] A non-resident enterprise's profits are, by default, only taxable in its state of residence unless it conducts business in the source state through a permanent establishment located there, according to the framework of the OECD Model Tax Convention on Income and on Capital (OECD Model), the fundamental document supporting the global network of double tax treaties.[6] According to Article 5 of the OECD Model, the permanent establishment concept can take two main forms: either as an agency permanent establishment under Article 5(5), where a dependent agent regularly acts on the enterprise's behalf in that state in a way that establishes a sufficient functional nexus between the enterprise and the source jurisdiction, or as a fixed place of business permanent establishment under Article 5(1), where the enterprise

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[1] OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 2015) p 11.
[2] Leonardo F. M. Castro, 'Problems Involving Permanent Establishments: Overview of Relevant Issues in Today's International Economy' (2012) 2 *Global Bus L Rev* 125, 131.
[3] OECD, Action 1 (n1), p 79.
[4] OECD, *Tax Challenges Arising from Digitalisation -Interim Report 2018* (OECD Publishing 2018) pp 15–16.
[5] Giuseppe Persico, 'Agency Permanent Establishment under Article 5 of the OECD Model Convention.' (2000) 28 *Intertax* 66, 67.
[6] OECD, *Model Tax Convention on Income and on Capital 2017 (Full Version)* (OECD Publishing 2019), Art 7.

maintains a physical facility in the source state through which it operates.[7] The exact scope and interpretation of Article 5 directly determines how taxing rights are distributed among states and, ultimately, how much tax multinational corporations pay.[8] The existence of a permanent establishment serves as the gateway to source taxation of business profits, and the amount of those profits then must be determined under Article 7.[9]

Cross-border economic activity required a physical presence, and Article 5's emphasis on “fixed places of business” and agents who “concluded contracts” accurately reflected how businesses interacted with foreign markets.[10] These presumptions underpinned the traditional permanent establishment framework, which was largely uncontroversial in the pre-digital era.[11] Because of this, the interpretation of Article 5 has always placed a strong emphasis on concrete commercial activities that take place within a jurisdiction, emphasizing the “fixed place” definition of paragraph 1.[12] However, technical advancements started to cast doubt on these assumptions starting in the middle of the 20th century.[13] Digital business models can be broadly defined as corporate structures that use digital technology, data, and online networks to provide goods or services across borders. The emergence of platform-based and data-driven business models caused what the OECD’s Action 1 Task Force on the Digital Economy described as the distinguishing characteristic of contemporary digital enterprises: the ability to generate substantial revenues in a jurisdiction without maintaining the physical infrastructure that permanent establishment analysis requires.[14] Through commissionaires and similar arrangements, sophisticated multinationals started to take advantage of this structural vulnerability, constructing local operations to stay just short of the permanent establishment requirement but keeping all the commercial substance of one.[15] The pre-BEPS agency PE rule proved particularly susceptible to such manipulation, given its formalistic focus on whether the

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[7] Benjamin Hoffart, ‘Permanent Establishment in the Digital Age: Improving and Stimulating Debate Through an Access to Markets Proxy Approach.’ (2007) 6 *Nw. J. Tech. & Intell. Prop* 106, 106.
[8] John C. Huston & Robert L.Williams, ‘*Permanent Establishments: A Planning Primer*.’ (Deventer, Boston: Kluwer Law and Taxation Publishers, 1993) p 2; OECD Model (2017) (n 6), Commentary on art 5, para 1.
[9] Ibid.
[10] Arthur J. Cockfield, ‘Reforming the Permanent Establishment Principle through a Quantitative Economic Presence Test’ (2003) 38 *Can Bus LJ* 400, 401.
[11] Gary D. Sprague and Rachel Hersey, ‘Permanent Establishments and Internet-Enabled Enterprises: The Physical Presence and Contract Concluding Dependent Agent Tests’ (2003) 38 *Ga L Rev* 299, 300.
[12] Castro (n 2), p 131.
[13] Ibid.
[14] OECD, Action 1 (n 1), pp 64-67.
[15] Arthur Pleijsier, ‘The Artificial Avoidance of Permanent Establishment Status: A Reaction to the BEPS Action 7 Final Report’ (2016) 6 *Int Transf Pricing J* 442,442-443.

agent possessed legal authority to conclude contracts in the enterprise's name, a criterion easily circumvented by ensuring formal contract conclusion occurred outside the source jurisdiction[16]

In response, BEPS Action 7 introduced a revision of Article 5(5) and (6) of the OECD Model Convention which significantly expanded the agency permanent establishment rule by moving beyond the formal requirement of contract conclusion.[17] Their main focus was to address commissionaire structures and other so called "artificial avoidance" techniques that that "are currently used to circumvent the existing PE definition."[18] The provision now captures situations in which a person habitually plays the principal role leading to the conclusion of contracts that are routinely finalized by the enterprise without material modification.[19] As clarified by the OECD Commentary, this includes cases where contractual outcomes are effectively determined in a jurisdiction, even if formal approval occurs elsewhere.[20] As a result, a permanent establishment may arise where a person acts as a functional sales force of the enterprise, regularly generating contracts on its behalf. However, activities limited to mere promotion or marketing, which do not directly lead to the conclusion of contracts, remain outside the scope of the rule.[21] Due to its formalistic emphasis on the legal conclusion of contracts, the pre-BEPS agency permanent establishment rule was heavily criticized for enabling multinational corporations to avoid permanent establishment status through arrangements like commissionaires, even though they continued to have a significant economic presence.[22] BEPS Action 7 addressed these shortcomings by redirecting the emphasis from the formal conclusion of contracts to the substantive role played in their conclusion, in an effort to better align the permanent establishment threshold with economic reality.[23]

Yet, the revised Article 5(5) still assumes a human agent exercising meaningful discretion, which becomes problematic when commercial activity in a source jurisdiction is carried out through automated processes, recommendation algorithms, or platform

[16] Justus Eisenbeiss, 'BEPS Action 7: Evaluation of the Agency Permanent establishment.' (2016) 44 *Intertax* 481, 482-483.
[17] OECD, *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, (OECD Publishing, 2015); OECD Model (2017) (n 6), Article 5(5).
[18] Ibid, BEPS Action 7, p 9.
[19] Ibid.
[20] Carlo Garbarino, 'Permanent Establishment and BEPS Action 7: Perspective in Evolution' (2019) 47 *Intertax* 365, 376.
[21] Ibid.
[22] Eisenbeiss, (n 16), p 483.
[23] OECD, *BEPS Action 7* (n 17), pp 17-18.

infrastructure.[24] These reforms address the specific avoidance structures without reconfiguring the framework's conceptual foundations. In contrast to the physical or representational presence that Article 5 was intended to identify, digital firms pose a qualitatively different problem: their economic presence can be real and frequently significant, but it is mediated through data, intangible assets, and user interaction.[25]

1.1 Research Question

Against this background, this thesis seeks to address the following research question: *"Does the revised agency permanent establishment rule under BEPS Action 7 effectively prevent the artificial avoidance of permanent establishment status in digital and platform-based business models, or does the digital economy require a complementary nexus standard beyond Article 5 OECD?"*.

This question's significance goes far beyond its doctrinal implications. At stake is the legitimacy and coherence of the international tax system's response to one of the most economically significant changes in the history of business and tax law.[26] If the revised agency permanent establishment rule fails to capture the economic presence of digital enterprises in market jurisdictions, the result is not merely a technical gap in treaty law; it is a systematic mismatch between the jurisdictions that bear the social and infrastructural costs of a digital enterprise's market activities and those that receive tax revenue from those activities.[27] The public's trust in the ability of the international tax system to adapt to modern economic realities is undermined by this gap, which also jeopardizes tax equality between nations and competitive fairness between digital and non-digital enterprises.[28] As a result, the question of whether Action 7 is adequate, or whether a different or additional digital nexus requirement is necessary, lies at the nexus of international governance, political economy, and tax law, making it both a topic of great policy relevance and scholarly curiosity.

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[24] Lisa Spinosa, 'A Long-Term Solution for Taxing Digitalized Business Models: Should the Permanent Establishment Definition Be Modified to Resolve the Issue or Whether the Focus Should Be on a Shared Taxing Rights Mechanism?' (2018) 46 *Intertax* 476, 478-479.

[25] José Ángel Gómez Requena & Saturnina Moreno González, 'Adapting the Concept of Permanent Establishment to the Context of Digital Commerce: From Fixity to Significant Digital Economic Presence' (2017) 45 *Intertax* 732, 734.

[26] OECD, Action 1 (n 1), pp 99–100.

[27] Spinosa (n 24), p 477.

[28] Ibid.

The main aim of this study is to critically assess the practical effectiveness of the post-BEPS concept of permanent establishment particularly to the agency PE, as well as its legal coherence in relation to Article 5 of the OECD Model. Emphasis will be placed on the way it interacts with business models that do not have a significant physical presence, as will its capacity to deal with avoidance structures found in pre-BEPS case law, such as *Zimmer* and *Philip Morris*, as well as in modern digital tax planning techniques. More specifically, the thesis will provide a systematic assessment of the extent to which BEPS Action 7 has modified the agency permanent establishment rule and whether these modifications materially reduce opportunities for artificial avoidance through commissionaire arrangements.

This thesis mainly adopts a doctrinal legal research approach in order to analyse and interpret international tax law sources such as the OECD Model Tax Convention, the BEPS Action 7 Final Report, and the appropriate OECD Commentary, as well as academic literature and case law. Furthermore, a restricted comparative approach is used to investigate the differences in approach between the OECD Model and the United Nations Model Convention, particularly in terms of the definition and extent of the agency permanent establishment requirement and the nexus approach.

Along with the introduction and a conclusion chapter, this thesis is organized into three main chapters. The conceptual and legal foundation is presented in Chapter 2, which examines the purpose and structure of Article 5 OECD and its relationship with Article 7, the conceptual distinction between the fixed place of business PE and the agency PE, and the pre-BEPS agency PE rule together with the commissionaire, fragmentation and contract-splitting structures that exposed the limits of the traditional framework. Chapter 3 turns to the pre-BEPS avoidance structures and the BEPS Action 7 response: it analyses the leading case law, such as *Zimmer* and *Philip Morris* and the meaning of artificial avoidance before examining the revised principal role test and the independent agent exception, and critically assessing their efficacy against those avoidance structures. The revised framework is then applied to digital and platform-based business models in Chapter 4, which also addresses the ongoing nexus issues that Action 7 does not resolve and compares the OECD approach with that of the UN Model Convention. The thesis concludes by summarizing the results and providing a definitive response to the research question, to the extent that it is currently feasible.

CHAPTER 2 - THE PERMANENT ESTABLISHMENT FRAMEWORK: FOUNDATIONS AND KEY CONCEPTS

2.1 The Purpose and Structure of Article 5 OECD and Its Relationship with Article 7 OECD

The concept of permanent establishment occupies a crucial position within the international tax treaty system, serving as the primary allocative mechanism through which source states acquire the right to tax the business profits of foreign enterprises operating within their jurisdiction.[29] Without a permanent establishment, a non-resident enterprise remains, in principle, beyond the reach of the source state's corporate income tax on its trading activities, even where those activities generate substantial revenues within that jurisdiction. The permanent establishment threshold thus operates as a *gateway* to source taxation: it defines the minimum degree of economic nexus that must exist between a foreign enterprise and a market jurisdiction before that jurisdiction may assert taxing rights over the enterprise's business profits.[30]

The origins of the permanent establishment concept lie in the nineteenth-century German states, where it developed as a response to problems of double taxation between Prussian municipalities.[31] The Austro-Hungarian-Prussian tax treaty of 1899 marked its international expansion, and the League of Nations' work, especially its 1928 model tax convention project, further developed the idea.[32] However, it was the OECD Model Convention of 1977 and the OECD Draft Double Taxation Convention of 1963 that combined Article 5 in its current form and made it the main standard for bilateral tax treaty practice.[33]

For the purposes of bilateral tax treaties based on the OECD Model, "permanent establishment" is defined in Article 5 of the 2017 OECD Model Tax Convention on Income and on Capital.[34] According to the IBFD Research Staff, this concept is the cornerstone of the

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[29] Castro (n 2), p 126; Arvid Aage Skaar, "*Permanent Establishment: Erosion of a Tax Treaty Principle*", 2nd edn (Kluwer Law International 2020) p 3.
[30] Hoffart (n 7), p 107.
[31] Michael Kobetsky, *International Taxation of Permanent Establishments: Principles and Policy* (Cambridge University Press 2011) pp 109-110.
[32] League of Nations, "*Double Taxation and Tax Evasion: Report Presented by the General Meeting of Government Experts on Double Taxation and Tax Evasion*"(League of Nations, 1927) Report Document C. 216. M. 85, p 15.
[33] OECD, *Draft Double Taxation Convention on Income and Capital* (OECD Publishing, 1963); OECD, *Model Double Taxation Convention on Income and Capital* (OECD Publishing, 1977).
[34] OECD Model (2017) (n 6), Art 5(1); Kobetsky (n 31), ch 5.

distribution of taxation rights with regard to cross-border commercial activities, and as such, it has a position of structural primacy inside any bilateral tax treaty based on the OECD framework.[35] The clause is divided into eight paragraphs, each of which focuses on a different aspect of PE. A Permanent Establishment is defined under paragraph 1 as "a fixed place of business through which the business of an enterprise is wholly or partly carried on".[36] A non-exhaustive list of instances that will initially be regarded as permanent establishments is given in paragraph 2.[37] These examples include places of management, branches, offices, factories, workshops, mines, and other locations where natural resources are extracted.[38] The building or installation project PE is covered in paragraph 3, which states that a site only qualifies as a permanent establishment if it lasts more than a year.[39] From an avoidance point of view, paragraph 4 is especially important because it lists a number of activities that, even in cases where a physical place of business is maintained, are not considered permanent establishments as long as they are auxiliary or preparatory in nature.[40] This is supplemented by paragraph 4.1, which was added in 2017 under the BEPS project, with an anti-fragmentation rule intended to stop businesses from purposefully breaking up coherent companies operations into component activities, each of which is then presented as separately preparatory or auxiliary.[41] The so called "agency" PE is regulated under paragraphs 5 and 6, which sets the conditions under which a legally distinct individual acting on behalf of a foreign firm may create a permanent establishment in the source state.[42] The agent does not need to be resident in the source state or have a fixed place of business there.[43] What matters is not only formal signature, but whether the agent is able to negotiate the essential elements of contracts in a way that binds the enterprise.[44] In addition, the authority must be exercised on a repeated rather than isolated basis, although no precise frequency threshold can be established.[45] Chapters 3 and 4 of this thesis provide a thorough analysis of the provisions' substantive nature and effects. Finally,

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[35] J. de Goede and others, 'Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention: Response from IBFD Research Staff' (2012) 66 *Bulletin for International Taxation* 313, 313.
[36] OECD Model (2017) (n 6), Article 5 (1).
[37] OECD Model (2017) (n 6), Article 5(2)(a)-(f).
[38] Ibid.
[39] OECD Model (2017) (n 6), Art 5(3).
[40] OECD Model (2017) (n 6), Art 5(4)(a)-(f); OECD Model (2017) (n 6), Commentary on Article 5, para 59.
[41] OECD Model (2017) (n 6), Art 4.1; Ibid (n 39) Commentary on Article 5, para 79.
[42] OECD Model (2017) (n 6), Art 5(5)-(6).
[43] João Sérgio Ribeiro, 'Outline of Article 5 of the OECD Model Convention' (2009) 1(115) *Jurisprudence* 295, 306.
[44] Ibid.
[45] Ribeiro (n 43).

Paragraph 7 makes it clear that a parent-subsidiary relationship does not automatically make one company a permanent establishment of the other.[46] Paragraph 8, which was added in 2017, defines "closely related" enterprises in terms of the independent agent exception and the anti-fragmentation rule.[47]

Moreover, Article 5's structural importance stems from its inextricable connection to Article 7 OECD, which governs business profit taxation. According to Article 7(1), unless the firm operates in the other state through a permanent establishment located there, a contracting state may not tax the profits of an enterprise of the other contracting state.[48] As a result, the Permanent Establishment serves as a *conditio sine qua non* for source taxation of corporate profits.[49] The latter are often only taxable in the state of residence when there is no Permanent Establishment.[50] This establishes a two-step analytical framework: the first question is whether a permanent establishment exists in the source state under Article 5; only if this is the case then the second question, what profits are attributable to that establishment and hence taxable, come into play.[51] Furthermore, attributable profits are those that the permanent establishment would be expected to make as a hypothetical separate and independent enterprise carrying out the same activities under the same conditions, according to the 2010 amendment of Article 7, which reflects the OECD's Authorized Approach.[52] According to scholars, this functional interdependence between Articles 5 and 7 means that the geographic distribution of company tax revenue among states is directly determined by the exact interpretation and extent of the permanent establishment definition.[53] Therefore, any change to the scope or interpretation of Article 5, whether through judicial construction, OECD Commentary revision, or treaty amendment, carries direct distributional consequences, reshaping the balance of taxing rights

[46] OECD Model (2017) (n 6), Art 5(7).
[47] OECD Model (2017) (n 6), Art 5(8); OECD Model (2017) (n 6), Commentary on Article 5, para 119.
[48] OECD Model (2017) (n 6), art 7(1); Brian J. Arnold, 'Threshold Requirements for Taxing Business Profits under Tax Treaties' (2003) 57 *BIT* 476, 478.
[49] Michael Lang, *Introduction to the Law of Double Taxation Conventions*, 3rd edn (Linde Verlag 2021) p 85; Persico (n 5), p 67.
[50] Ibid.
[51] OECD, *Report on the Attribution of Profits to Permanent Establishments* (OECD Publishing 2008) Part I, para 9; Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle* (2020) (n 29) pp 3-4.
[52] OECD Model (2017) (n 6), Art 7(2); OECD, *Additional Guidance on the Attribution of Profits to Permanent Establishments, BEPS Action 7* (OECD Publishing 2018) pp 9-10.
[53] Lang (n 49), p 65.

between residence and source states and ultimately determining how much of the tax burden generated by cross-border commercial activity falls on each.[54]

2.2 The Fixed Place of Business PE and the Agency PE: Conceptual Distinctions

After outlining the overall framework and purpose of Article 5 OECD, it is now necessary to make a more detailed distinction between its two main operational forms: the fixed place of business permanent establishment and the agency permanent establishment.[55] Both use conceptually distinct methods to accomplish the same fundamental goal, which is to create a sufficient nexus between a foreign company and the source state for the taxation of business earnings.[56] While the latter is focused on the actions of an individual working on the enterprise's behalf, the former is rooted in the enterprise's actual presence in the source state.[57]

The “classic” type of permanent establishment is the fixed place of business PE, which is outlined in Article 5(1).[58] It represents the conventional belief that conducting cross-border commerce typically necessitates having a steady physical presence in the market jurisdiction.[59] In this way, the examples given in Article 5(2), are not distinct categories but rather a non-exhaustive list of the more general notion that the business conducts its operations through a physically recognizable location.[60] The conditions for establishing a fixed place of business permanent establishment are cumulative but closely interlinked, and of unequal weight: as authors observes, where one condition is satisfied with evident certainty the remaining criteria may be assessed more flexibly, with the permanence test generally outweighing the geographic and disposal conditions.[61] Firstly, for the creation of a physical permanent establishment, a business has to exist, meaning that it must be related to the exercise of a business undertaking and it has to have a core nature. Secondly, there must be the existence of a place of business which is defined by scholars “as any substantial, physical object which is commercially suitable

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[54] Reuven S. Avi-Yonah, Kimberly A. Clausing, “Business Profits (Article 7 OECD Model Convention)” ch 2 in Michael Lang, Pasquale Pistone, Josef Schuch, Claus Staringer ‚*Source versus Residence: Problems Arising from the Allocation of Taxing Rights in Tax Treaty Law and Possible Alternatives* (EUCOTAX, Kluwer law International 2008), p 9.
[55] Jean Schaffner, *How Fixed Is a Permanent Establishment?* 42 (Kluwer Law International 2013), ch 4-5.
[56] Ibid.
[57] Sprague and Hersey (n 11), p 299.
[58] Schaffner (n 55), p 118.
[59] Ibid.
[60] OECD Model (2017) (n 6), Commentary on Art 5, para 45.
[61] Schaffner (n 55), pp 120.

to serve as the basis for a business activity', and which constitutes the permanent establishment.[62]

The third requirement is that the enterprise must carry a business activity in the premises, however it is not a condition that the whole business must be exercised there and it doesn't necessarily need to be successful.[63] Moreover, only when a company uses a fixed place of business and has adequate control over its use, it can be considered a permanent establishment.[64] The crucial point is that the location must be practically accessible to the firm so that it can carry out its operations, instead of having an incidental or abstract connection.[65] This "disposal test" is however, not directly found in the wording of Article 5 OECD, but stems from the OECD Commentary.[66] Another requirement (which is connected to the geographical and disposal condition), is that the enterprise must fulfil the "permanence test", namely there needs to be some continuity in the business operations that are conducted in the PE.[67] Activities in the source state that are merely infrequent or sporadic are insufficient.[68] Therefore, rather than the actual premises, the permanence requirement relates to the commercial activity carried out through the premises.[69] Additionally, the place of business has to be connected to a fixed geographical point in the source state.[70] The premise does not need to be permanently immovable, visible, or incapable of relocation: it is sufficient that the enterprise carries out its activity through an identifiable and spatially delimited location.[71] Finally, It is not necessary for employees to be present all the time for the PE to have a fixed place of business.[72] If the other requirements of Article 5(1) are satisfied, a PE may also occur when automated equipment is used for commercial operations.[73] Additionally, if a company has multiple sites within the same state, they can only be grouped together if they make up a cohesive geographic

[62] Arvid Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle*, Series on International Taxation, (Kluwer Law and Taxation, 1991), p 123.
[63] Ekkehart Reimer, Nathalie Urban, Stefan Schmid, *Permanent Establishments - A domestic taxation, bilateral tax treaty and OECD perspective*, 42 (Wolters Kluwer, 2010).
[64] Schaffner (n 55), p 136.
[65] Ibid.
[66] OECD Model (2017) (n 6), Commentary on Art 5, para 12.
[67] Schaffner (n 55), p 146-147.
[68] Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle* (1991) (n 62), p 209.
[69] Ibid.
[70] OECD Model (2017) (n 6), Commentary on Art 5, para 28.
[71] Reimer, Urban and Schmid (n 63), p 43.
[72] Sarig Shalhav, 'The revised permanent establishment rules' (2003) 4 *Intertax* 131, 139.
[73] Schaffner (n 55), p 171.

and commercial entity.[74] If not, each site needs to be evaluated independently.[75] A single PE by itself does not attract all of the company's other profits or activities inside that jurisdiction.[76]

Moreover, Article 5(2) provides for a non-exhaustive list of what could amount to a fixed PE, such as an office, a factory, a branch, a mine or a work-shop. Therefore, an infrastructure or a building could still be considered a PE even though it's not listed under paragraph 2 and there are double tax treaties that expands the list, such as the one between Luxembourg and Singapore.[77]

In contrast, the agency PE is independent of the presence of the enterprise's own facilities in the source state.[78] When a legally distinct individual, working on behalf of a non-resident enterprise, regularly creates contractual obligations that are binding on that enterprise within the source jurisdiction, the agency PE under Article 5(5) of the OECD Model is triggered.[79] It is important to note, that Article 5(5) should be considered as a supplementary mechanisms of within the PE framework.[80] Furthermore, It is necessary to determine if the business already has a fixed site PE under Article 5(1) or, in the case of construction activities, a construction PE under paragraph 3 before implementing the agency PE regulation.[81] There is no need to rely on Article 5(5) for the same activities if there is such a PE. Some scholars argue that paragraph 3 (construction PE) should have been include in the wording of Article 5(5), "Notwithstanding the provisions of paragraphs 1 and 2…" in order to make this concept more clear.[82] An explanation for this could be that the construction PE was originally part of the 1963 OECD Model's general PE definition in paragraph 1 but was eventually moved to its own paragraph.[83]

When a foreign business operates in the source state through a dependent agent, an agency PE may arise, such an agent may be an individual or a legal body, and they are not

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[74] Schaffner (n 55), p 171.
[75] Ibid.
[76] Schaffner (n 55), p 173.
[77] Schaffner (n 55), p 174-175; *Income Tax (Singapore-Luxembourg) (Avoidance of Double Taxation Agreement) (Modifications to Implement Multilateral Instrument) Order 2019* (In force 1 August 2019).
[78] Castro (n 2), p 138.
[79] Ibid (n 6), OECD Model Convention, Article 5(5).
[80] Arthur Pleijsier, 'The Agency Permanent Establishment: The Current Definition - Part One', (2001), 29 *Intertax* 167, 167-168.
[81] Ibid.
[82] Pleijsier, 'The Agency Permanent Establishment: The Current Definition - Part One' (n 80); Klaus Vogel, *Klaus Vogel on Double Taxation Conventions,* 4th ed. (Kluwer Law International 2015), p 305.
[83]Ibid, Klaus Vogel p 305; OECD Model (2017) (n 6), Article 5(3).

required to work for the company.[84]Article 3(1)(a) provides a definition of persons as " an individual, a company and any other body…". Unless the agent has actual authority to bind the enterprise, mere involvement in talks or attendance at business meetings is insufficient to establish an agency PE.[85] On the other hand, as long as they operate in the regular course of their own business, brokers, general commission agents, and other agents of independent status are excluded under Article 5(6).[86] The distinction between dependent and independent agents has frequently led to ambiguity, in part because the evaluation may rely on the particular language of the relevant tax treaty as well as the interpretation chosen in each legal system.[87] Several requirements needs to be fulfilled in order for a person or legal entity to be considered a dependant agent capable of giving rise to an agency PE. Firstly, a person must act on behalf of the foreign company, consequently, the agent serves as principal for the foreign company rather than conducting its own business.[88] The agent is paid for its services, but the business assumes the financial risk and keeps the profits.[89] This is consistent with the so called "replacement theory", a term used by Arthur Pleijsier that underpins Article 5(5), which states that an entity may be deemed present in the source state if another individual successfully conducts business operations in its place.[90] The agent must either be legally or economically dependent on the principal; it must have the authority to enter into contracts under the principal's name; regularly use this authority; and not be (assimilated to) a broker or general commission agent, which must be economically and legally independent from the principal, acting in the regular course of his business.[91]

In contemporary words, the pertinent question is whether the firm has projected its operations into the jurisdiction through a dependent representative whose activities are adequately linked to its commercial operations, rather than whether it has created a material site in the jurisdiction.[92] The source-state relationship originates from representation rather than location, which explains why the agency PE is frequently referred to as a more functional form

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[84] Castro(n 2), p 139; OECD Model (2017) (n 6), Commentary on Article 5, para 83.
[85] Castro (n 2), p 139.
[86] OECD Model (2017) (n 6), Article 5(6)
[87] Cormac Kelleher, "Problems with Permanent Establishments" (TTN) 1,3 < https://www.ttn-taxation.net/pdfs/prizes/CormacKelleherEssay.pdf> last accessed 14 May 2026.
[88] Pleijsier, 'The Agency Permanent Establishment: The Current Definition - Part One' (n 80), p 168.
[89] Ibid.
[90] Schaffner (n 55), p 219-218; Pleijsier, 'The Agency Permanent Establishment: The Current Definition - Part One' (n 80), p 168.
[91] OECD Model (2017) (n 6), Article 5(5)-(6); Schaffner (n 55), p 219.
[92] Schaffner (n 55), pp 219 -251.

of nexus.[93] Moreover, as previously described, there are many issues that needs to be discussed when assessing whether an agency PE has arisen and it requirements, which will be examined in more detail in the subsequent chapter of this thesis.

Thus, the difference between a fixed place PE and an agency PE is not just textual. A fixed place PE inquires as to whether the company has used a stable physical environment to embed a portion of its business operations in the source state.[94] Even in the absence of such a setting, the agency PE addresses a different scenario entirely: one where the enterprise has no fixed presence in the source state, but operates there through an intermediary who can bind it to contracts with third parties.[95] As a result, the fundamental factual questions are different. The examination in the case of a fixed place PE concentrates on issues like the location, permanency, and presence of the place of business.[96] The connection between the enterprise and the intermediary, whether the latter is autonomous or dependent, whether it has the power to enter into contracts, and if that power is regularly used rather than occasionally, becomes more important in the case of an agency PE.[97]

2.2.1 The Historical Differences of the Fixed Place PE and the Agency PE

This distinction is also historically significant. The early OEEC work on the permanent establishment article led to the development of the agency PE rule, as evidenced by the origins of Article 5(5) of the OECD Model.[98] The OEEC Working Party 1, which was made up of delegates from Germany and the United Kingdom, wrote the original PE document. Its first report was published in 1956.[99] This historical context is crucial because the common law and civil law concepts of agency, which did not entirely align, interacted to form the agency PE rule.[100]

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93 David Feuerstein, 'The Agency Permanent Establishment' in Michael Lang, Florian Brugger and Patrick Plansky (eds), *Permanent Establishments in International and EU Tax Law* (Linde 2011) pp 105, 107–108.
94 Ribeiro (n 43) p, 296.
95 Arthur Pleijsier, 'The Agency Permanent Establishment in BEPS Action 7: Treaty Abuse or Business Abuse?' (2015) 43 *Intertax* 120, 121.
96 Schaffner (n 55), pp 125-127.
97 Kruthika Prakash, 'Permanent Establishments under the OECD Model (2017) Based on the Principal Role Leading to the Conclusion of Contracts: A Doctrinal and Policy Analysis' (2020) 74 *Bulletin for International Taxation* 1.
98 John F. Avery Jones and Jürgen Lüdicke, 'The Origins of Article 5(5) and 5(6) of the OECD Model' (2014) 6 *World Tax J* 203, 203-204.
99 Ibid.
100 Avery Jones and Lüdicke (n 98), pp 204-208; Schaffner (n 55), pp 221-222.

The requirement that the person concludes contracts "in the name of" the enterprise does not necessarily require the existence of an agency relationship in the strict civil law sense.[101] Rather, the provision raises broader questions of representation and authority, which have historically been controversial because civil law and common law systems attach different meanings to the concept of "agency".[102] Specifically, the early drafts of the agency PE provision referred to an agent acting "on behalf of" an enterprise.[103] Concluding contracts "in the name of" the principal has a specific technical meaning from a civil law standpoint: it relates to direct representation, in which the agent discloses the principal to the third party and the resulting contract directly binds the principal.[104] This requirement is not met by a "commissionaire" or "Kommissionär" who acts in his own name on behalf of the principal, leaving him completely exempt from Article 5(5).[105] In contrast, the phrase "in the name of" had no legal significance from a common law standpoint. The distinction between acting "on behalf of" and "in the name of" had no operative meaning in UK tax law because almost all agent contracts bind the principal regardless of how the contracting is characterized.[106] However, the requirement that the agent enter into contracts "in the name of" the firm, took the place of the previous phrasing in the final wording, primarily due to the French drafting process.[107] The OEEC secretariat's translation replaced *pour le compte de* with *au nom de*, the civil law formulation, and the English text was eventually changed to comply : firstly in the OEEC First Report and subsequently incorporated into the 1963 OECD Draft.[108] Ultimately, in both civil law and common law systems, an agent acts in the interest of the principal, so that the legal or economic consequences of the agent's activity ultimately affect the principal rather than the agent itself.[109] However, the legal mechanism through which this result is achieved differs significantly between civil law and common law traditions.[110]

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[101] Detlev J. Piltz, 'When is there an agency permanent establishment?' (2004) 58 *IBFD* 196, 196; Ibid (n 5), pp 68-69.
[102] Schaffner (n 55), pp 221- 222; Persico (n 5) p 69.
[103] Avery Jones and Lüdicke (n 98), pp 209-215.
[104] Avery Jones and Lüdicke (n 98), pp 208-209; Schaffner (n 55), pp 223-224.
[105] Avery Jones and Lüdicke (n 98), p 208.
[106] Avery Jones and Lüdicke (n 98), p 204-205; Persico (n 5), pp 68-69.
[107] Avery Jones and Lüdicke (n 98), p 221.
[108] Avery Jones and Lüdicke (n 98), pp 215-218; Persico (n 5), 68-70; John .F. Avery Jones and David A. Ward, 'Agents as Permanent Establishments under the OECD Model Tax Convention' (1993) 33 *European Taxation* 154, 171.
[109] Persico (n 5), p 68.
[110] Ibid; Sidney I .Roberts, 'The Agency Element of Permanent Establishment: The OECD Commentaries from the Civil Law View (Part One)', (1993), 9 *Intertax* 396, 399-400.

On the other hand, the origins and the interpretation of the fixed place PE have been less controversial. In contrast to the agency PE, the IBFD Research Staff has noted that the text of Article 5(1) has not altered significantly since the 1963 OECD Draft Convention, with the principal evolution occurring through the Commentary rather than the provision itself, indicating a degree of underlying consensus over its fundamental content.[111] The fixed place of business concept's relative stability stems from the fact that its operative test, a physical location at the enterprise's disposal that is fixed in terms of both geography and time, rests on objectively verifiable factual criteria that do not necessitate engagement with the controversial legal concepts of agency and representation that have caused ongoing disagreement across legal systems.[112] According to some scholars, the fixed place PE reflects a supply-based theory of taxing jurisdiction that necessitates a physical connection between the company and the source state.[113] This theoretical foundation is universally accepted among OECD member states and, as a result, generates significantly less drafting dispute. This limb of Article 5 differs from the structurally more controversial agency PE rule in that the disputes that have emerged, particularly with regard to the "at the disposal" requirement and the preparatory or auxiliary activity exceptions, are issues of application rather than of conceptual design.[114]

The crucial aspect for this thesis is that these two types of PE react differently to various sorts of participation in cross-border markets.[115] The fixed location PE covers situations where the business is physically present in the source state; the agency PE covers situations where the business does not have a physical foundation but acts there through a dependent and suitably empowered intermediary.[116] They both serve the same purpose of justifying source taxes, but they do it in different ways conceptually.[117] This distinction becomes particularly significant in the later chapters of this thesis, since many of the avoidance structures targeted by BEPS Action 7, and many of the challenges presented by digitalized business models emerge precisely in the gap between these two categories.

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[111] de Goede and others (n 35), p 313-314.
[112] Avery Jones and Lüdicke (n 98), p 208; Ribeiro (n 43),p 297.
[113] Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle* (2020) (n 29), p 4.
[114] de Goede and others (n 35), pp 314-315; Schaffner (n 55), pp 137-139.
[115] Schaffner (n 55), ch 4-5.
[116] Eisenbeiss (n 16) p 492.
[117] Ibid.

2.3 The Pre-BEPS Agency PE Rule: Meaning and Requirements

The text of Article 5(5) and (6) was substantially amended with the BEPS Action 7 Reform of 2017, which have implemented the conclusions of the 2017 update.[118] Before we dive into these updates, it is important to discuss the previous definition and wording of agency PE and its weaknesses. As previously discussed, the agency PE operated as a deeming provision: if a person acted on behalf of a foreign enterprise and satisfied the conditions of Article 5(5), the enterprise could be treated as having a permanent establishment in that state, even though it had no premises of its own there.[119] The rule was based on a limited and mostly formal understanding of agency; the key question was whether the agent had enough legal power to bind the principal by signing contracts.[120] Drawing from the 1929 report of the League of Nations Fiscal Committee, Pleijsier noted that this was interpreted as “a criterion of a legal nature, it being considered that the only agents dependent on an enterprise are those having sufficient powers to conclude contracts binding upon that enterprise.”[121] The main prerequisites of this pre-BEPS architecture are examined in turn in the following subsections.

2.3.1 Article 5(5)

2.3.1.1 The “Acting In The Name Of” and “On Behalf Of” Expression

The wording of Article 5(5) requires both that the person acts “on behalf of” the enterprise and that it “conclude contracts in the name of” the enterprise.[122] The more general relational criterion of “acting on behalf of” establishes that the agent acts for the principal's account and in its best interests.[123] Since both common law and civil law acknowledge that an agent's actions may be economically attributable to the principal even when the agency nominally contracts in its own name, it is typically uncontroversial across legal traditions.[124] In contrast, the operative legal standard that establishes whether an agency PE occurs is “in the name of,” and this is where the provision's interpretation challenges are concentrated.[125]

[118] OECD, BEPS Action 7 (n 17).
[119] Pleijsier, ‘The Agency Permanent Establishment: The Current Definition - Part One’ (n 80), pp 167-168.
[120] Pleijsier, ‘The Artificial Avoidance of Permanent Establishment Status: A Reaction to the BEPS Action 7 Final Report’(n 15), p 443.
[121] Pleijsier, ‘The Agency Permanent Establishment: The Current Definition - Part One’ (n 80), p 177; League of Nation LON, Doc. C.516.M.176.1929.II, Geneva, October 1926, 1929, p 3.
[122] OECD, *Model Tax Convention on Income and on Capital 2014 (Full Version)*, (OECD Publishing 2015) Article 5(5).
[123] Pleijsier, ‘The Agency Permanent Establishment: The Current Definition - Part One’ (n 80), p 169.
[124] Persico (n 5), p 68;
[125] Avery Jones and Lüdicke (n 98), pp 208-209; Mihir Naniwadekar, ‘Analysing BEPS Action 7 in the Context of Agency PEs’, (2024) 52 *Intertax* 24, 25-26.

In civil law and common law systems, the expression "acting in the name of" the enterprise has distinct meanings.[126] In civil law, it is closely related to direct representation, in which the principal is directly bound by the contract and the agent acts in the principal's behalf.[127] On the other hand, in common law, regardless of whether the agent formally operated in the principal's name, the fundamental question is typically whether the principal is legally obligated.[128] In an effort to resolve this divergence in interpretation, the OECD amended paragraph 32 of the Commentary in 1994.[129] This amendment made it clear that the phrase "authority to conclude contracts in the name of the enterprise" does not limit the application of paragraph 5 to agents who enter into contracts literally in the enterprise's name, but rather extends it equally to agents who conclude contracts that are binding on the enterprise even when those contracts are not in the enterprise's name.[130] Pleijsier saw this alteration as a significant shift in agency PE taxation, essentially abandoning the civil law requirement that contracts be made literally "in the name of" the principle, in favour of the more expansive standard of legal bindingness.[131] However, because the OECD drafters altered only the Commentary and not the treaty text itself, an obvious inconsistency remained: an agent concluding binding contracts without acting literally in the name of the principal could constitute a PE according to the Commentary, yet the unchanged treaty text continued to require the "in the name of" formulation.[132]

Overall, this phrase has traditionally been interpreted broadly. Consequently, the decisive question is not whether the contract formally identifies the principal as the contracting party, but whether the agent's actions create contractual obligations that are legally binding on the principal.[133] Notably, the "in the name of" requirement had to be met in every case, before BEPS Action 7, in order to find an agency PE.[134]

[126] Persico (n 5), p 69.
[127] Ibid.
[128] Ibid.
[129] Pleijsier, 'The Agency Permanent Establishment: The Current Definition - Part One' (n 80), p 177.
[130] Ibid.
[131] The Agency Permanent Establishment: The Current Definition - Part One' (n 80) pp 177–178.
[132] Pleijsier, 'The Agency Permanent Establishment: The Current Definition - Part One' (n 80), p 178; Naniwadekar (n 125), p 26.
[133] Naniwadekar (n 125), p 26.
[134] Ibid.

2.3.1.2 The "Authority To Conclude Contracts" And The "Habitual Exercise" of That Authority

According to Article 5(5) of the OECD Model of 2014, an agency PE must have "an authority to conclude contracts" and he must "habitually exercise" it, as briefly discussed under section 2.2.[135] This phrase it closely linked to the "in the name of" of the enterprise requirement, however there is no definition of "authority" in the OECD Model, and Article 3(2) states that terms that are not defined in the Treaty text shall have the meaning under the law of the State.[136] The relevant distinction is between internal authority, which concerns the authorisation given by the principal to the agent, and external authority, which concerns the agent's ability to bind the principal vis-à-vis third parties.[137] Some scholars, considers external authority to be decisive, since internal authority may be unreliable where domestic law allows the principal to ratify unauthorised acts afterwards.[138] Another question under the pre-BEPS agency PE regulation was whether the agent required to formally sign the contract or if a significant contribution to the bargaining process would be adequate.[139]. Paragraph 33 of the Commentaries stipulates that mere involvement in negotiations does not, on its own, amount to authority to conclude contracts.[140] Nevertheless, it remains relevant in determining the role actually performed by the agent.[141] Where the principal does not intervene despite knowing that the agent is acting on its behalf, or later ratifies the agent's acts, the agent may be considered to have implicit authority.[142] In this sense, authority may arise not only from express authorisation, but also from the conduct of the principal and agent, which is also referred to as "pseudo-authorisation."[143] Regarding this matter, it is important to mention the Italian *PhilipMorris* case, where it was decided that direct involvement in contract negotiations was enough to be regarded as power to enter into agreements on behalf of the principal.[144]

[135]OECD Model (2014) (n 122), Article 5(5).
[136] Ibid, Article 3(2).
[137] Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle* (1991) (n 62), p 498.
[138] Pleijsier, 'The Agency Permanent Establishment: The Current Definition - Part One' (n 80), p 171.
[139] Schaffner (n 55), p 229.
[140] OECD, *Model Tax Convention on Income and on Capital 2010 (Full Version)* (OECD Publishing, 2010), Commentary on Article 5, para 33.
[141] Ibid.
[142] OECD Model (2010) (n 140), para 32.1; Huston & Williams (n 8), p 88.
[143] Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle* (1991) (n 62), p 500.
[144] *Italy vs "Philip Morris"*, March 2002, Supreme Court, Cases No 3368/2002.

Moreover, the authority also had to cover contracts pertaining to the "business proper" of the enterprise.[145] Authority limited to auxiliary or preparatory activities, like advertising or purchasing, could not ground an agency PE even in cases where it was regularly exercised.[146] Sasseville and Skaar confirms that the investigation was mainly focused on whether the agent's acts effectively bound the principal in the relevant market and it was ultimately a question of fact and substance rather than form.[147]

In order for an agency PE to exist, the agent must also "habitually exercise" the authority; this requirement drew a parallel with the permanence requirement in the fixed place of business PE: an isolated or irregular use of contracting authority was insufficient prior to BEPS, just as a merely transient physical presence could not give rise to a PE under Article 5(1).[148] Both requirements needed to be met at the same time and are equally important.[149] Most notably, "habitually" denoted a combination of frequency and permanence, distinguishing ongoing activity from isolated intervention.[150] Even in industries where contracts are not usually concluded on a frequent basis, the habituality requirement still demands a certain degree of regularity.[151] For this reason, scholars have argued that the conclusion of only one agreement within a two-year period would normally not be enough to establish an agency PE.[152] Furthermore, in pre-BEPS case law, the application of this criteria produced (and still produces) conflicting outcomes.[153] The German Federal Fiscal Court has indicated that the "habitual exercise" requirement is not met merely because an agent is present in the source state for a limited number of days, even though the German tax authorities had argued that this was sufficient to create an agency permanent establishment for the principal.[154] Finally, it is important to mention that the wording "habitually exercise " has stayed the same even after the amendments of BEPS Action 7, and still causes discussion.[155]

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145 OECD Model (2014) (n 122), Commentary on Article 5 para 33.
146 Schaffner (n 55), p 231; Pleijsier, 'The Agency Permanent Establishment: The Current Definition - Part One' (n 80), p 178.
147 Jacques Sasseville and Arvid Skaar, General Report, in International Fiscal Association, *Is there a permanent establishment?* vol. 94a (The Hague: Sdu Uitgevers, 2009), p 53.
148 OECD Model (2014) (n 122), Article 5(5); Schaffner (n 55), p 231.
149 Ibid.
150 Alessandro Caridi, 'Proposed changes to the OECD commentary on Article 5: Part II – The construction PE notion, the negative list and the agency permanent establishment' (2003) 43 *European Taxation* 38, 38.
151 Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle* (1991) (n 62),p 527.
152 Ibid.
153 Naniwadekar (n 125), p 26.
154 *Bundesfinanzhof*, 3 August 2005, I R 87/04.
155 Naniwadekar (n 125), p 32.

In addition to these pre-BEPS requirements and interpretations, some more general amendments that are worth noting are the addition of the e-commerce section in 2003 and the variation of a specific service PE in 2008.[156] The former was one of the first attempts to adapt the PE concept to digital business. It clarified that a website, being composed of software and data, cannot itself amount to a fixed place of business because it lacks physical presence.[157] A server, however, may qualify as a fixed place of business if it is physically located in a state and used by the enterprise.[158] The approach therefore shows that the OECD's early response to digitalisation still remained anchored in the traditional physical presence requirement and, as some scholars argue, the digital economy is largely fitted into the existing PE framework, instead of the framework itself being substantially reconsidered to respond to new forms of digital business activity.[159]

2.3.2 Article 5(6)

2.3.2.1 The Dependency Status of the Agent

Even where a person satisfied the conditions of Article 5(5), no agency PE would arise if that person qualified as an independent agent acting in the ordinary course of its business within the meaning of Article 5(6) of the OECD Model.[160] The notion of dependency, is thus a very important aspects to discuss in the pre-BEPS context; what constitute a dependant (or independent) agent? The provision expressly excluded from PE status "a broker, general commission agent or any other agent of an independent status", provided such persons were acting in the ordinary course of their business.[161]A broker can therefore still constitutes an agency PE if he fulfils Article 5(5) of the OECD Model. The relationship between Article 5(5) and Article 5(6) has historically been debated.[162] One view considered Article 5(6) as an independent rule, meaning that agents who did not satisfy its conditions could create a PE even if the requirements of Article 5(5) were not met.[163] However, this interpretation is problematic,

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[156] Svetislav V. Kostić, 'New Law on Permanent Establishment', Chapter 3, in Joanna Wheeler, "*The Aftermath of BEPS"* (IBFD, 2019), pp 79-80; OECD, *Model Tax Convention on Income and on Capital: Condensed Version (*OECD Publishing *2003*), Commentary on Article 5, para 42.1-42.10; OECD, *Model Tax Convention on Income and on Capital: Condensed Version (*OECD Publishing *2008*), Commentary on Article 5, para 42.23.
[157] Ibid, OECD Model (2003), Commentary on Article 5.
[158] Ibid.
[159] Kostić (n 156), p 81.
[160] OECD Model (2014) (n 122), Commentary on Article 5, para 36-39.
[161] Ibid, Article 5(6) ; Persico (n 5), p 66.
[162] Mattia Calabrese, 'Taxing the Dependent Agent Permanent Establishment in the State of Source: What Has Been Achieved through the Modifications to Article 5?' Chapter 5 , in Joanna Wheeler, "*The Aftermath of BEPS"* (IBFD, 2019), p 128-129.
[163] Ibid.

since Article 5(6) should not itself extend taxing rights in the source state where there is no sufficient connection with that state.[164] Another view treats Article 5(6) as an exception to Article 5(5), while a third approach interprets the two provisions together.[165] The latter approach is better since it avoids conflict between the two paragraphs: the agent's independence should be evaluated before determining whether Article 5(5)'s other requirements, such as the authority to bind the principal, are met.[166] Despite, the Commentary stated that it was mainly added "for the sake of clarity and emphasis" on the grounds that an independent agent, representing a separate enterprise, would logically not be attributable to the foreign principal.[167] However, authors emphasized the "failure to clarify the meaning of independence" as a recurring flaw in the clause, pointing out that the twofold requirement of independence created interpretive challenges: not only must the agent conduct its own business, but it also must not receive detailed instructions from the foreign principal while doing so.[168]

Article 5(6) served a crucial practical purpose, especially in common law jurisdictions where independent agents frequently enter into contracts that are binding on their principals.[169] This aspect in also important in terms of interpretation as brokers and commission agents, may be understood differently in civil law and common law systems.[170] In civil law, a commissionaire acts on behalf of the principal but in its own name, so it does not normally bind the principal directly.[171] As a result, in civil law countries, commissionaires may fall outside Article 5(5) because they do not conclude contracts binding on the foreign enterprise.[172] By contrast, in common law systems, the analysis focuses more directly on whether the intermediary is legally and economically independent from the principal and whether it acts in the ordinary course of its business.[173]

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164 Calabrese (n 162) , p 129.
165 Avery Jones and Lüdicke (n 98), pp 223-227; Hans Pijl, 'Agency Permanent Establishments: In the Name of and the Relationship between Article 5(5) and (6) - Part 2' (2013) 67 *Bull. Intl. Taxn*. 62.
166 Calabrese (n 162), p 129; Pijl (n 165), p 94.
167 OECD Model (2014) (n 122) Commentary on Article 5, para 36; Pleijsier, 'The Agency Permanent Establishment: The Current Definition - Part One' (n 80), p 178.
168 Roberts (n 110), p 396; Jérôme Monsenego, 'The Independent Agent Exception and Group Membership', (2018) 46 *Intertax* 944, 945.
169 OECD Model (2014) (n 122), Commentary on Article 5, para 36; Persico (n 5), p 79.
170 Calabrese (n 162), p 129-130.
171 Avery Jones and Lüdicke (n 98), pp 218-219.
172 Ibid.
173 Ibid.

Two cumulative requirements, namely legal independence and economic independence, had to be satisfied for an agent to be eligible under the pre-BEPS Article 5(6).[174] It should be mentioned that until the OECD Commentary was amended in 1994, it was sufficient for an agent to meet either criterion; the requirement that both elements be met at the same time was only added at that time, greatly reducing the exemption's scope.[175] Importantly, group participation was not a condition that directly and automatically affected the independent status because the pre-BEPS version of Article 5(6) did not clearly distinguish between related and unrelated firms.[176] The previous clause, which was more objective and fact-based, concentrated on how the agent conducted its business.[177]

Legal independence needed that the agent be free to carry out business in accordance with its own procedures, expertise and own view, free from the principal's complete control or explicit instruction.[178] In *Taisei Fire and Marine Insurance Co*., the US Tax Court stated that "even an independent agent only has authority to perform specific duties for the principal, it is freedom in the manner by which the agent performs such duties that distinguishes him as independent."[179] The pre-BEPS Commentary notably held that a shareholder's control over its subsidiary was irrelevant to the independence assessment, meaning that even direct or full ownership did not automatically preclude independent status, which was in line with Article 5(7) of the OECD Model.[180] Overall, the main criteria to determine the status of the agent (dependent or independent) are the control that a shareholder exercise over its subsidiary and "the extent of the obligations" that an agent has towards the foreign enterprise, as indicated by the Commentary.[181] The phrase "extent" can both refer to the numbers of contractors of the agent and to the nature of the obligations that stems from the contracts.[182]

In turn, economic independence meant that the agent's company had to be able to support itself financially without depending on the principle. Five pertinent components were recognized by the 2014 Commentary: the foreign enterprise's instructions, the extent of its

[174] Monsenego (n 168), p 946; OECD Model (2014) (n 122), Commentary on Article 5, para 37(a); Pleijsier, 'The Agency Permanent Establishment: The Current Definition - Part One' (n 80), p 180.
[175] Schaffner (n 55), pp 238-246.
[176] Monsenego (n 168), pp 946-947.
[177] Ibid.
[178] Pleijsier, 'The Agency Permanent Establishment: The Current Definition - Part One' (n 80), p 180.
[179] *Taisei Fire and Marine Insurance Co v Commissioner*,104 T.C. No. 27, 104 T.C. 535, (1995).
[180] OECD Model (2014), Commentary on Article 5 (n 122), para 38.1.
[181] OECD Model (2014), Commentary on Article 5 (n 122), para 104; Monsenego (n 168), p 947.
[182] Monsenego (n 168), p 947.

control, the party that assumed the entrepreneurial risk, the agent's expertise, and the number of principals it represented.[183] As demonstrated by the *InverWorld* case, where a US business that completed around 90% of its work for one Cayman parent was no longer seen as independent, an agent who worked exclusively, or nearly exclusively, for a single principal ran the risk of being viewed as economically dependent.[184] Schaffner further notes that an arm's length remuneration is a strong indicator of economic independence, while a fixed remuneration insufficient to cover the agent's costs would point in the opposite direction.[185]

2.4 Commissionaire Arrangements, Fragmentation, Contract Splitting and the Limits of the Traditional PE Framework

The conceptual framework set out in this chapter, the dual structure of Article 5, the pre-BEPS agency PE rule's formalistic reliance on contract conclusion "in the name of" the enterprise, and the historically conditioned divergence between civil law and common law interpretations, reveals structural vulnerabilities that sophisticated multinational enterprises did not fail to exploit.[186] The limitations of the traditional PE paradigm were revealed by three avoidance strategies in particular. First, and most importantly for this thesis, *commissionaire arrangements* allowed enterprises to operate commercially active local entities that generated all the economic substance of a dependent agent while formally escaping the pre-BEPS Article 5(5) agency PE threshold by ensuring that contracts were concluded by the commissionaire in its own name rather than that of the principal.[187] Second, multinational corporations were able to neutralize the construction PE rule without actually fragmenting the underlying commercial operation through contract splitting, which is the artificial division of a single commercial project or set of related contracts among connected entities so that no individual contract meets the applicable time threshold under Article 5(3), which is discussed under paragraph 18 of the Commentary on Article 5.[188] Third, and more widespread, activity fragmentation made it

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[183] Caterina Innamorato, 'The concept of permanent establishment within a group of multinational enterprises' (2008) 42 *European Taxation* 81, 82; OECD Model (2014), Commentary on Article 5 (n 122), para 38-38.3.
[184] *InverWorld Ltd. v. Comm*., TC Memo 1996-301 (1996); Luis Eduardo Schoueri, Oliver-Christoph Günther, 'The subsidiary as a permanent establishment', (2011) 65 *Bulletin for International Taxation* 69, 70.
[185] Schaffner (n 55), p 242.
[186] Ching Khee Tan and Henry Syrett, 'Impact of OECD Beps Action 7 Proposals on Modification of Articles 5(4), 5(5) and 5(6) of OECD Model Convention - An Evaluation of Action 7 on the Future of Intra-Group Transactions and Business Models of MNEs in their Cross-Border Investments.' (2017) 5 *Singapore Management University School of Accountancy Research* 1, 29-31.
[187] Pleijsier, 'The Artificial Avoidance of Permanent Establishment Status: A Reaction to the BEPS Action 7 Final Report' (n 15), p 444; OECD, BEPS Action 7 (n 17); Persico (n 5), pp 76-77.
[188] OECD, *BEPS Action 7* (n 17), pp 42-43.

possible for businesses to split up what was essentially a cohesive business operation among several fixed locations of business so that, when considered separately, each one seemed to fall under the preparatory or auxiliary exceptions of Article 5(4), even though the total amount of activities would have clearly exceeded that threshold.[189] For the discussion and purpose of this thesis, the most relevant avoidance technique is the commissionaire arrangement which is closely related to the agency PE status and will be discussed in more detail in the following chapter.

Together, these techniques revealed a structural paradox that the pre-BEPS framework could not resolve from within: as Eisenbeiss observed, because the avoidance of PE status produced an outcome, no source-state tax liability, that was formally consistent with the general rule of residence-state taxation, any challenge to such arrangements necessarily depended on the contested concept of "artificiality", a standard that became progressively more difficult to apply as globalisation and the emergence of new business models deepened the conflict between states with opposing interests in the residence-source balance.[190]

[189]OECD, *BEPS Action 7* (n 17), pp 39-41; Garbarino (n 20), pp 370-371.
[190] Eisenbeiss (n 16), p 492.

CHAPTER 3: PRE-BEPS AVOIDANCE STRUCTURES AND THE BEPS ACTION 7 RESPONSE

Having clarified the meaning and requirements of the pre-BEPS agency permanent establishment rule and its main issues, it is now clearer why there was the need for a change. BEPS-Action 7 was aimed at preventing the Artificial Avoidance of Permanent Establishment (PE) status as part of its Base Erosion and Profit Shifting initiative.[191] Additionally, it intended to deal with challenges of the digital economy as discussed in Action 1: "Addressing the tax challenges of the digital economy."[192] It identified the definition of PE as a vulnerable point in the international tax system, especially in relation to commissionaire arrangements, similar sales structures, the fragmentation of activities and the use of independent-agent exceptions.[193] This project was focused on revising and improving the current flaws in the system instead of developing a completely new definition of PE or creating a new concept of nexus related to the significant economic presence.[194] Overall, BEPS Action 7 brought about significant amendments to the 2017 OECD Model Tax Convention and additions to its commentary, in particular to Article 5(5) and 5(6).[195]

3.1 The Concept of Artificial Avoidance of Permanent Establishment Status

The expression "artificial avoidance" recalls the reasoning of the Court of Justice in *Cadbury Schweppes,* where this expression was heard for the first time, although that case concerned controlled foreign company rules rather than permanent establishments.[196] The court defined a "wholly artificial arrangement" as "a fictitious establishment not carrying out any genuine economic activity in the territory of the host Member State".[197] In contrast, the OECD's definition of "artificial" in the context of PE is not made explicit in BEPS Action 7.[198] The term "artificial" generally refers to something that is not natural, but rather constructed, simulated or false according to the Cambridge Dictionary.[199] In the tax context, this meaning is relevant when combined with the concept of "avoidance", the term refers to the structuring of a

[191] A. Pleijsier 'The Artificial Avoidance of Permanent Establishment Status: A Reaction to the BEPS Action 7 Final Report' (n 15), p 442.
[192] OECD, Action 1 (n 14).
[193] OECD, BEPS – Action 7 (n 17).
[194] A. Pleijsier, 'The Agency Permanent Establishment in BEPS Action 7: Treaty Abuse or Business Abuse?' (n 95), p 147; Kostić (n 156), p 83.
[195] Naniwadekar (n 125), p 24.
[196] Case C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I-07995, para 68-72.
[197] Ibid, para 68.
[198] OECD, BEPS – Action 7 (n 17).
[199] Cambridge Dictionary, "Artificial", <https://dictionary.cambridge.org/dictionary/english/artificial> last accessed 5 June 2026.

taxpayer's affairs in order to reduce tax liability, even where the arrangement remains formally lawful.[200] The difficulty, therefore, lies in the fact that artificial avoidance may comply with the literal wording of the law while undermining its underlying purpose.[201] The OECD primarily refers to structures like commissionaire arrangements, which were already mentioned in the previous section, and which were frequently employed to divert revenues from the state in which sales occurred.[202] This approach was criticised by some scholars, claiming that using the word "artificial" runs the risk of labelling all commissionaire agreements as fake, which is not always the case.[203] According to other authors, artificial avoidance is defined as intentional "business model manipulation" with the "sole purpose to simply avoid the formation by an entity of a PE in a particular (high tax) jurisdiction," leading to an "ultimate loss of tax base."[204] The essential problem, however, is that the widespread use of commissionaire arrangements exposed flaws in the way Article 5(5) and Article 5(6) were drafted, namely that an agent could conclude contracts under its own name and avoid falling under the agency PE paragraph.[205]

3.1.1. Commissionaire Arrangements

In order to evaluate the reforms to the agency permanent establishment rule introduced by BEPS Action 7, and to substantiate the argument developed in this thesis that those reforms were ultimately insufficient, it is first necessary to examine the commissionaire structures. Commissionaire arrangements are particularly relevant in civil law systems, where direct and indirect representation are treated differently.[206] Civil law makes a distinction between circumstances in which an intermediary works in the principal's name and those in which it acts in its own name, in contrast to common law, which primarily concentrates on whether the principal is bound by the agent's contract.[207]

As previously mentioned a commissionaire concludes sales contracts with customers in its own name but in reality on behalf of the foreign principal, leaving the principal and agent

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[200] Calabrese (n 162), p 137.
[201] Ibid.
[202] Pleijsier, 'The Artificial Avoidance of Permanent Establishment Status: A Reaction to the BEPS Action 7 Final Report' (n 15), p 444.
[203] Philip Baker, 'Dependent Agent Permanent Establishments: Recent OECD Trends', ch 3 In Michael Lang *Dependent Agents as Permanent Establishments* (Linde, 2014), p 31.
[204] Martin Sumper and Claire Estebanez, 'Digitization and New Business Models: The Concept of the Permanent Establishment Today and Tomorrow' (2017) 1, 4.
[205] Ibid (n 184).
[206] Amar Mehta, 'The New Law on Permanent Establishment in the Digital Economy (as of October 2018)', ch 4 in *Dependent Agents as Permanent Establishments* (Linde, 2014), pp 107-108.
[207] Ibid.

relationship hidden from the customer.[208] Moreover, the foreign principle bears the majority of the risk, function performance, and investment in the local market, while the commissionaire assumes low risk, performs limited functions, and barely uses its own assets.[209] The commissionaire's compensation was also limited.[210] From a tax perspective, this meant that the source state could generally tax only the limited remuneration of the local commissionaire, while the main sales profit remained attributable to the foreign principal.[211] Importantly, the commissionaire never obtains legal title to the inventory; instead, the goods move straight from the principal to the client, even if the principal is usually kept secret from the customer.[212] Although the principal benefits from the sales contracts, it is not legally bound by them.[213] Under the pre-BEPS version of Article 5(5) OECD MTC, which mandated that contracts be concluded "in the name of the enterprise," it was precisely this feature, the principal's lack of legal obligation, that historically prevented the commissionaire from constituting a dependent agent PE of the principal.[214]

It is also important to remember, that commissionaire arrangements were never the exclusive application of the idea of artificial avoidance of PE status. Tan Ching Khee and Henry Syrett note that while some multinational corporations structured their operations to avoid double taxation through careful PE management, a commercially legitimate goal, others went much further, creating structures intended to produce double non-taxation, which resulted in profits being left untaxed not only in the source state but essentially everywhere.[215] As previously mentioned, the other avoidance techniques available were the operation through a fixed place of business for storage, display, or delivery activities while carefully managing the scope of those activities to stay just within the preparatory or auxiliary exemptions under Article 5(4) and the division of a coherent economic process among several locations so that each one seemed to qualify as just auxiliary or preparatory on its own, even if the whole business would obviously not.[216]

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[208] JohanVisser & Gerbrand Hidding, 'Taxable Nexus: Moving toward an Economics-Based Approach' (2019) 71 *Tax Executive* 28, 30; Sumper and Estebanez (n 204), pp 26-27; Eisenbeiss (n 16), p 483.
[209] Ibid.
[210] Ibid.
[211] Pleijsier, 'The Agency Permanent Establishment in BEPS Action 7: Treaty Abuse or Business Abuse?' (n 95), pp 147-148.
[212] Oliver R. Hoor and Keith O'Donnell, 'BEPS Action 7: The Attempt to Artificially Create a Taxable Nexus' (2015) 78 *Tax Notes International* 929, 930-931.
[213] Ibid.
[214] Ibid.
[215] Tan and Syrett, (n 186), pp 6-7.
[216] Ibid, p 6; OECD, BEPS Action 7 (n 17), pp 28-39.

3.2 Leading Case Law: *Zimmer* and *Philip Morris*

As follows from the previous paragraph, commissionaire arrangements are based on a dual contractual structure.[217] The commissionaire concludes a contract with a third party, usually the customer, in its own name, while a separate internal contractual relationship exists between the commissionaire and the principal.[218]

Only the internal contract between commissionaire and principal is legally binding on the latter, not the contracts concluded by the commissionaire with customers, for these reasons, commissionaire arrangements have typically been held not to give rise to an agency PE in civil law jurisdictions.[219] This position was confirmed by the French Supreme Administrative Court in the leading case of *Zimmer*.[220] The facts concerned Zimmer SAS, a French entity that had originally acted as a distributor of products manufactured by its UK parent, Zimmer Limited.[221] In 1995, the arrangement was restructured so that Zimmer SAS operated as a commissionaire, selling products in France in its own name but on the account of, and at the commercial risk of, Zimmer Limited, which remained an undisclosed principal vis-à-vis French customers.[222] The French tax authorities contended that Zimmer Limited had a permanent establishment in France, arguing that Zimmer SAS was a dependent agent with authority to bind its UK parent, a position initially upheld by the Administrative Court of Appeals of Paris on a factual analysis.[223] The *Conseil d'État*, however, reversed this conclusion, holding that contracts concluded by a commissionaire with customers do not directly bind the principal, and that a commissionaire therefore cannot in principle constitute a permanent establishment of the principal merely by selling its products in its own name.[224] The court did acknowledge that a different outcome could arise where the contract of commission, or other factual elements surrounding the appointment, demonstrated that the principal was in fact personally bound, but it treated this as an exceptional possibility and offered limited guidance on what such circumstances might entail in practice.[225]

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[217] Mehta (n 206), p 108.
[218] Ibid.
[219] Conseil d'État, *Société Zimmer Limited v. Ministre de l'Économie, des Finances et de l'Industrie*, Nos 304715 and 308525 (31 March 2010).
[220] Ibid.
[221] Ibid; Schoueri and Günther (n 184) pp, 69-70.
[222] *Société Zimmer Limited* (n 219); Bruno Gouthière, 'Zimmer:'Commissionaire' Agent Is Not a Permanent Establishment', (2010) 8 *European Taxation* 350, 351.
[223] Ibid; Naniwadekar (n 125), p 28.
[224] *Société Zimmer Limited* (n 219).
[225] Ibid; Conseil d'État, *Ministre c/ Société Interhome AG*, No 224407 (20 June 2003) Recueil Lebon.

In the older case of Philip Morris, the Italian Supreme Court of Cassation came to a very different conclusion.[226] The case involved Intertaba SpA, an Italian member of the Philip Morris group whose main business was the production and distribution of cigarette filters. However, it had overseen the execution of a licence agreement between the Italian Tobacco Administration and other Philip Morris group companies, taken part in its negotiation, and performed a number of tasks for the exclusive benefit of foreign group members without getting paid.[227] The Italian tax authorities argued these activities constituted a "disguised" permanent establishment for the non-resident entities, a position rejected by both lower courts on the basis that neither a fixed place of business nor a dependent agency relationship had been established.[228] The Supreme Court reversed these decisions ruling that a subsidiary's employees' involvement in negotiations on behalf of a foreign parent was enough to prove that the subsidiary was a dependent agent and, thus, a permanent establishment of the parent.[229] The court found that participation in contract negotiations could fall under the concept of contracting authority even in the absence of any formal power of representation because it explicitly prioritized substance over form, stating that the assessment of authority to conclude contracts must be anchored in economic reality rather than civil law categories.[230] International tax specialists widely criticized the Philip Morris ruling, which was justified in the opinion of this thesis.[231] In direct response to that criticism, the OECD changed its Commentary in 2005 to make it clear that each group entity's permanent establishment determination must be completed separately, that a shareholder relationship between group companies does not automatically result in an agency permanent establishment, and that the particular requirements of Article 5(5) must be independently met.[232] *Zimmer* and *Philip Morris* together expose the central weakness of the pre-BEPS agency PE framework: two major civil law jurisdictions applying the same provision reached opposite conclusions, one prioritising legal form, the other economic substance.

[226] Corte di Cassazione (Italian Supreme Court of Cassation), *Italian Ministry of Finance v Philip Morris*, No 7682 (25 May 2002).
[227] Ibid; Schoueri and Günther (n 184), pp 71-72.
[228] *Italian Ministry of Finance v Philip Morris* (n 144); Provincial Tax Court of Milan, "*Philip Morris*", No. 238 (12 September 1997); Regional Tax Court of Milan, "*Philip Morris*", No. 313/99, (24 March 2000).
[229] *Italian Ministry of Finance v Philip Morris* (n 144).
[230] Ibid; Naniwadekar (n 125), p 27.
[231] Schaffner (n 55), p 245.
[232] OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2005*, (OECD Publishing, 2005), Commentary on Article 5, para 30-35, 40-41.1.

3.3 The BEPS Action 7 Reform of Article 5(5) and 5(6): The Revised Principal Role Test and the Independent Agent Exception

The OECD reformed the agency permanent establishment rule in hope to improve and avoid the risk of artificial avoidance and commissionaire against the immediate backdrop of the inconsistencies revealed by *Zimmer* and *Philip Morris,* as well as the pre-BEPS framework's wider susceptibility to commissionaire arrangements and other structures without substance.[233] Consequently, BEPS Action 7 project came up with a new Article 5(5) and 5(6), shifting the focus towards the substantive nature of the activities performed in the source state rather than the formalistic approach that had proved incapable of accommodating the divergent civil law and common law conceptions of agency.[234]

According to the amended Article 5(5), a permanent establishment may occur when an individual acting on behalf of an enterprise regularly enters into contracts or "habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modifications by the enterprise" as long as those contracts are (a) in the enterprise's name, (b) for the transfer of ownership or the right to use property owned by the enterprise, or (c) for the provision of services by that enterprise.[235] Two structural changes follow from this wording. First, the controversial "in the name of" requirement survives only as one of three alternative limbs; the addition of limbs (b) and (c) deliberately shifts the focus from who is legally bound by the contract to the subject matter of the contract, so that the formal civil-law distinction between direct and indirect representation, which had shielded the commissionaire in *Zimmer*, can no longer be decisive.[236] Eisenbeiss notes that the focus on the goal of the contract creates an objective economic connection between the foreign firm and the intermediary, resulting in a uniform treatment of commissionaires in both common-law and civil-law regimes.[237] Second, the addition of the "principal role" limb expands the application of the rule to include agents whose actions are the primary cause of contracts' conclusion, rather than just those who legally finalize them.[238]

Critics have pointed out that the updated Commentary provides the interpretive content of these new criteria in an unequal manner.[239] According to paragraph 32.4, "concludes

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[233] Calabrese (n 162), p 133.
[234] Ibid.
[235] OECD Model (2017) (n 6), Article 5(5); Eisenbeiss (n 16), p 487.
[236] OECD Model (2017) (n 6), Commentary on Article 5, para 32.4; Hoor and O'Donnell (n 212), p 933.
[237] Eisenbeiss (n 16), p 487-488.
[238] Ibid.
[239] Eisenbeiss (n 16), pp 487-488; Garbarino (n 20), p 376-377.

contracts” refers to circumstances in which a person legally concludes a contract; active negotiation of the terms is not necessary, and simply accepting an offer may be sufficient; a contract may even be considered concluded by the agent if it is signed outside of the customer's state.[240] The same Commentary confirms that the provision is not confined to contracts that create rights and obligations legally enforceable between the enterprise and the third party, but extends to contracts that will in substance be performed by the enterprise rather than by the person formally bound, which is the textual mechanism by which the commissionaire is brought within the rule.[241] Furthermore, in paragraph 32.6, the “principal role” limb is exemplified by an agent who persuades a customer to accept the enterprise's standard terms.[242] Although the enterprise formally executes the contract, the conclusion is a direct result of the agent's solicitation, relationship-building, and communication with the client.[243]

The Revised Discussion Draft's “negotiates the material elements of contracts” wording, which was heavily criticized for the ambiguity of both “negotiates” and “material elements”, was replaced by the “principal role” formulation.[244] However, as some scholars have argued, the substituted “principal role” standard is highly subjective in itself, requiring an implicit comparison of the agent’s and principal’s respective contributions to the contract’s conclusion while providing scarce guidance on key terms like “material modification”, which.[245] According to this perspective, the revision buys a wider threshold at the expense of the administrative simplicity, clarity, and certainty that an agency PE regulation is supposed to offer.[246]

Another requirement from the new wording of the Commentary on Article 5(5) is that the conclusion of contracts by the agent must “directly result” from the actions that he performs in a state on behalf of the principal.[247] Despite the fact that the “principal role” test is more broad, the latter criteria actually narrows down the scope: mere promotion, advertising or market preparation that contributes only indirectly to eventual sales falls outside the rule, as

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[240] OECD, *BEPS Action 7* (n 17), para 32.4; OECD Model (2017) (n 6), Commentary on Article 5, para 87-88.
[241] OECD Model (2017) (n 6), Commentary on Article 5, para 87; Garbarino (n 20), p 376.
[242] OECD, *BEPS Action 7* (n 17), para 32.6.
[243] Ibid.
[244] Eisenbeiss (n 16), p 488.
[245] Hoor and O'Donnell (n 212), pp 933-934; OECD Model (2017) (n 6), Article 5(5); OECD Model (2017) (n 211), Commentary on Article 5, para 88.
[246] Eisenbeiss (n 16), pp 487-488.
[247] OECD Model (2017) (n 6), Commentary on Article 5, para 88-89.

the Commentary's pharmaceutical-representative example confirms.[248] Consequently, whether the contract is officially signed "in the name of" the business is less significant under the post-BEPS norm.[249] Instead, the emphasis switches to whether the agent was a key factor in the contract's creation, which still leaves uncertainty where an agent initially convinces a customer to enter into a business relationship, but later orders are placed directly with the foreign enterprise without the agent's further involvement.[250]

The other major amendment made by the BEPS Action 7 Project is to the independent agent definition of Article 5(6).[251] The 2014 OECD Model version of paragraph 6 was formulated in the following way: "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". [252] As already mentioned in the previous Chapter, to assess the legal and economic independence of the agent, multiple factors had to be taken into account: the degree of control the principal had over how the work was completed, the agent's dependence on its own unique expertise and knowledge, the number of principals represented, and, most importantly, the sharing of entrepreneurial risk between the parties.[253] These criteria were also developed and well demonstrated by the body of leading insurance case law that evaluates independence using the aforementioned factors, such as the Canadian case of *American Income Life Insurance* and the American case of *Taisei Fire and Marine Insurance Company*.[254] According to Caridi's analysis of the 2002 revisions to the Commentary, an agent acting entirely or nearly entirely on behalf of a single principal could still be considered independent as long as the overall facts showed an independent business conducted at the agent's own risk and reward, which captured the orientation of the earlier regime.[255] BEPS Action 7 introduced a new approach specifically in the case of intra-group arrangements.[256] According to the new wording enterprises that act "acts exclusively or almost

[248] Ibid; Tan and Syrett (n 186), pp 36-37.
[249] Ibid, pp 38-39.
[250] Ibid.
[251] OECD, *BEPS Action 7* (n 17), pp 23-27.
[252] OECD Model (2014) (n 122), Article 5(6).
[253] Caridi (n 150), p 44; OECD Model (2014) (n 122), Commentary on Article 5, paras 38-38.8; Skaar *Permanent Establishment: Erosion of a Tax Treaty Principle* (1991) (n 62), p 503.
[254] *American Income Life Insurance Co v The Queen* (2008) TCC 306; *Taisei Fire and Marine Insurance Co v Commissioner* (n 179); Garbarino (n 20), pp 379-380.
[255] Caridi (n 150), pp 44-45.
[256] OECD, *BEPS Action 7* (n 17), p 16.

exclusively on behalf of one or more enterprises to which it is closely related" are excluded from being independent agents.[257] The new subparagraph (b) defines "closely related" as having control or holding more than 50% of the other person's beneficial interest, while the Commentary considers the "almost exclusively" requirement to be met when unrelated sales make up less than 10% of the sales the agent closes in its capacity as an agent.[258] Moreover, the removal of references to brokers and general commission agents from Article 5(6) shows the OECD's attempt to avoid legal terms that could create interpretative conflicts between civil law and common law systems, which was a major problem in the 2014 version.[259]Additionally, the Final Report's removed the economic-independence test limb that the previous Commentary's paragraph 37 had outlined.[260] As a result, a concept that was already ambiguous became even less clear, according to a number of critics.[261] Finally, the new version of Article 5(6) focuses the assessment of independent agent on whether the agent acts in the ordinary course of "that business", which seems to mean its own business activities.[262] In practice, the requirements of independence and ordinary course of business are closely connected: an agent will normally be regarded as independent where it carries out activities that belong to its own agency business, rather than activities unrelated to that business or performed under the control of the principal.[263]

3.4 Critical Assessment of the Reforms

When combined, the amendments to Articles 5(5) and 5(6) accomplish their immediate goal in relation to the paradigm of commissionaire arrangements: according to the prevailing scholarly analysis, a structure of the kind upheld in the *Zimmer* case would now give rise to an agency permanent establishment because the local entity routinely plays the principal role in contracts for the transfer of the principal's property and can no longer invoke the independent-agent exception once it is shown to act almost exclusively for a closely related enterprise.[264] Most scholars agree that revised rules make classic commissionaire structures harder to use to avoid the agency PE to rise, the new Article 5(5) is no longer limited to contracts formally

[257] OECD, *BEPS Action 7* (n 17), p 16; OECD Model (2017) (n 6), Article 5(6).
[258] OECD Model (2017) (n 6), Commentary on Article 5, para 112; OECD, *BEPS Action 7* (n 17) para 38.8-38.10.
[259] Calabrese (n 162), p 135; Pleijsier, 'The Artificial Avoidance of Permanent Establishment Status: A Reaction to the BEPS Action 7 Final Report' (n 15), p 444-445.
[260] OECD Model (2014), Commentary on Article 5 (n 122), para 37; Eisenbeiss (n 16), p 489.
[261] Ibid.
[262] Calabrese (n 162), p 136.
[263] Garbarino (n 20), p 378; OECD Model (2017) (n 6), Commentary on Article 5, para 110.
[264] Eisenbeiss (n 16), p 489; Hoor and O'Donnell (n 212), pp 932-933; OECD, *BEPS Action 7* (n 17).

concluded "in the name of" the foreign enterprise.[265] It now captures cases where the local person plays the principal role leading to contracts that are routinely finalised without material modification.[266] However, some authors still criticise the post-BEPS rule which remains centred on the conclusion of contracts, which they considers an inherently legal concept.[267] Firstly, some argue that the reform does not provide sufficient guidance for courts and tax authorities to adopt a genuinely substance-based approach when dealing with new structures that may be developed in response to the reform.[268] Even though the new rule refers to a person who plays the "principal role leading to the conclusion of contracts", the existence of a concluded contract remains central.[269] Therefore, the revised rule still invites analysis based on contract law rather than broader commercial reality and taxpayers may still be able to structure arrangements around legal concepts while achieving the same economic result.[270] More specifically, the changes made to Article 5(6) limit the ability of multinational groups to rely on the independent agent exception, particularly where the agent acts exclusively or almost exclusively for closely related enterprises.[271] Nevertheless, this solution has been criticised as formalistic and not fully justified in principle.[272] The deeper problem is that artificial avoidance in the agency PE context does not always arise from structures that lack commercial substance or are created solely to avoid tax.[273] Rather, it arises from the fact that the agency PE rule continues to reduce a commercial reality to formal legal tests, especially concepts such as contract conclusion and legal authority.[274]

A second critique is whether the reform actually eliminates avoidance or merely shifts it.[275] Some scholars argue that the new "principal role" and "material modification" standards are not as clear-cut as the previous tests.[276] This exchanges one type of uncertainty for another, creating the possibility of fact-based disagreements that are difficult to foresee but that skilled

265 Tan and Syrett (n 186), pp 32-33.
266 Ibid.
267 Naniwadekar (n 125), pp 30-31.
268 Ibid, p 36-37.
269 Ibid.
270 Ibid.
271 Garbarino (n 20), p 381.
272 Naniwadekar (n 125), p 31.
273 Ibid.
274 Ibid.
275 Richard Collier, 'Revised BEPS PE Proposals: Indeterminate Agents, Principals, and Principles' (2015) *Tax Notes International* 61, 63; Eisenbeiss (n 16), p 488.
276 Ibid.

businesses can prepare for.[277] Regarding Article 5(6), Eisenbeiss raises a similar point: while certainty is gained by turning the independence question into an essentially automatic exclusion for closely related agents, the separate-entity principle typically requires a case-by-case evaluation.[278] On this view, the reform does not really remove the planning opportunity. This thesis agrees with the position that it just shifts the argument from the legal form of the contract to the facts of what the local entity actually does, and that is still ground on which sophisticated groups can operate.

The limited scope on the prevention of artificial avoidance accomplishment is confirmed by two aspects of the updated provisions. First, arrangements in which the source-state interaction is automated or in which no individual's conduct is the primary cause of contracting fall completely outside of Article 5(5) since the norm still requires an identifiable person to play the principal role.[279] Second, even where an agency permanent establishment is found, the profit attributable to it may be minimal, what the source state may actually tax is determined by the authorised OECD approach, under which profit is attributed by reference to the functions performed, assets used and risks assumed at the establishment.[280] According to the OECD Transfer Pricing Guidelines the profits must be attributed to the closely related party in accordance with the arm's length principle,[281] consequently where the local entity has already been remunerated on an arm's-length basis for precisely those functions, as the typical commissionaire or limited-risk distributor has, little or no residual profit remains to attribute to the newly recognised PE.[282]

In conclusion, the revised provisions remain anchored to the existence of a person whose activity in the source state is the proximate cause of contracting; they amplify *which* such persons are caught, but they do not touch upon the requirement of a human agent at all.[283] Pleijsier's pre-reform remark that the agency rule is based on the *legal* concept of agency is still valid: a provision based on an intermediary who persuades, solicits, and binds is only

[277] Collier (n 275), p 62-63.
[278] Eisenbeiss (n 16), p 491-492.
[279] Ekkehart Reimer, 'Permanent Establishment in the OECD Model Tax Convention' in Ekkehart Reimer, Stefan Schmid & Marianne Orell, *Permanent Establishments: A Domestic Taxation, Bilateral Tax Treaty and OECD Perspective,* 5th Edn (Kluwer Law International, 2016), p 100; Eisenbeiss (n 16), pp 497–502.
[280] Eisenbeiss (n 16), p 497-502.
[281] OECD, '*OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022'*, (OECD Publishing, 2022), pp 31-32; OECD Model (2017) (n 6), Art 9(1).
[282] Eisenbeiss (n 16), p 497-498.
[283] Ibid, pp 492-493.

understandable in situations where such an intermediary is present.[284] This premise still holds for the traditional commissionaire arrangements that BEPS Action 7 reform tries to defeats. What about business models in which contracts with source-state customers are concluded through an automated interface, a platform, or an algorithm, with no person in the jurisdiction playing the role the provision presupposes? It is to those digitalised models, and to the question whether the post-BEPS framework can reach them at all, that the next Chapter analyses and tries to answer.

[284] A. Pleijsier, 'The Agency Permanent Establishment in BEPS Action 7: Treaty Abuse or Business Abuse?' (n 95), p 153-154.

CHAPTER 4: THE AGENCY PE RULE APPLIED TO DIGITAL AND PLATFORM-BASED BUSINESS MODELS

The preceding chapters established that BEPS Action 7, while broadening the category of persons capable of constituting a dependent agent, left the structural architecture of the agency permanent establishment rule intact: it still presupposes an identifiable person, acting in the source state, whose conduct is the proximate cause of the conclusion of contracts.[285] This chapter applies that analysis to the main question of the thesis, namely whether the digital economy necessitates a complementary nexus standard beyond Article 5 of the OECD Model or whether the revised rule under Articles 5(5) and 5(6) can prevent the artificial avoidance of permanent establishment status in digital and platform-based business models.

Long before the BEPS Project, the importance of this question and the structural nature of the challenge were recognized. Skaar, who wrote about electronic commerce as early as 2000, showed that automated online trading satisfies nearly every substantive requirement of the agency permanent establishment: legally binding contracts are routinely and frequently concluded through software on a server, on behalf of and for the benefit of the business that owns the website and the products sold, in a relationship of clear dependence.[286] According to his interpretation, the sole need that automated contracting does not satisfy is that the agent be a "person" as defined by Article 3(1)(a), since a server is only a machine and cannot be an entity for any legal purpose.[287] This led him to the conclusion that the more mobile and digital international business becomes, the less adequate are rules predicated on a physical presence at a fixed geographical point for a defined period.[288] What is striking, for the purposes of this thesis, is that the very feature Skaar identified as the rule's blind spot, the indispensability of a human (or at least legally recognisable) agent, is precisely the feature that BEPS Action 7 declined to tackle.[289]

This is significant because, as previously mentioned, the permanent establishment serves as the starting point for source-state taxation; in the absence of one, the source state is

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[285] OECD, *BEPS Action 7* (n 17), p 16; see Chapter 3 above.
[286] Arvid Aage Skaar, 'Erosion of the Concept of Permanent Establishment: Electronic Commerce' (2000) 28 *Intertax* 188, 192–194.
[287] Ibid, p 192; OECD, *Model Tax Convention on Income and on Capital 2000 (Full Version): Volumes I and II*, (OECD Publishing, 2000), Article 3(1)(a).
[288] Skaar, 'Erosion of the Concept of Permanent Establishment: Electronic Commerce'(n 286), p 194.
[289] Eisenbeiss (n 16), p 492.

unable to impose taxes on the company's profits, regardless of how significant its market activity is.[290] A rule anchored to such a person cannot reach digital and platform-based businesses that contract through automated interfaces or algorithms instead of a person playing the principal role.[291] This erodes source-state revenue and leads to unilateral measures that further fragment the international tax framework.[292] The following sub-section tries to give a definition of digital and platform based business models that are relevant for this thesis.

4.1 Defining Digital Business Models and Platform Enterprises

There is no single, authoritative legal definition of a "digital business model", and the OECD itself concluded in the Action 1 Report that the digital economy cannot meaningfully be ring-fenced, since the economy as a whole is constantly evolving and digitalising.[293] The Action 1 Report nonetheless isolated a recurrent set of features of such businesses that are relevant from a tax perspective: (i) a high degree of mobility, with respect both to the intangible assets on which the digital economy relies, to its users, and to its business functions; (ii) a heavy reliance on data; (iii) the importance of network effects, whereby the decisions of one user directly affect the benefit enjoyed by others; (iv) the prevalence of multi-sided business models, in which distinct groups of persons interact through an intermediary or platform; (v) a tendency toward monopoly or oligopoly where a model depends heavily on network effects; (vi) and volatility, due to low barriers to entry and rapidly evolving technology.[294] These were later categorised into three traits that are now commonly used as shorthand in the OECD's 2018 Interim Report: "scale without mass," that is, the capacity to achieve significant market presence in a jurisdiction with little or no physical footprint, a strong reliance on intangible assets, and the crucial role of data and user interaction.[295] It is the first and third category that are the most important for their direct impact on the PE analysis, since they describe value generated within a jurisdiction without the physical or human presence that Article 5 was designed to identify.[296]

The label nonetheless covers a heterogeneous range of activities, and the Action 1 Report distinguishes, among others, electronic commerce in goods and services, online

[290] OECD Model (2017) (n 6), Article 7(1); see Chapter 2 above.
[291] Eisenbeiss (n 16), p 493-496.
[292] Ibid.
[293] OECD, Action 1 (n 1), p 11.
[294] Ibid, p 143 para 366.
[295] OECD, *Tax Challenges Arising from Digitalisation* (2018) (n 4), pp 24-30, 50-57.
[296] Skaar, 'Erosion of the Concept of Permanent Establishment: Electronic Commerce' (n 286), p 192-193.

payment services, application stores, online advertising, cloud computing, high-frequency trading and participative networked platforms.[297] The ways in which these models engage with a market jurisdiction vary significantly. While some still require the delivery of tangible goods, others, like online advertising, cloud services, and participatory platforms, derive revenue from a jurisdiction's users through completely automated and remote means, with no local middleman entering into contracts on the enterprise's behalf.[298] According to the economic literature, a platform functions in a two-sided (or multi-sided) market when it serves two or more different user groups whose demand is interdependent, meaning that each group's value from the platform rises with the other's participation.[299] This dynamic is explained in terms of indirect network externalities and the platform's requirement to bring both sides of the market "on board."[300] Within the management and information-systems literature, a platform of this kind is defined more precisely by four cumulative conditions: it connects independent actors from a supply and a demand side through a digital interface; those actors enter into direct transactions with one another; the platform supplies only the institutional and technical framework within which they transact; and the platform does not itself produce or trade the goods or services exchanged.[301] The most notable characteristic of a digital platform enterprise is its function of enabling direct interaction between two or more distinct customer groups, each of which is affiliated to the platform; crucially, and in contrast to a reseller or a vertically integrated firm, the platform does not itself take title to the goods or services exchanged, but merely facilitates the transaction between the participating sides.[302] It is exactly this last feature that is decisive for the present analysis, since it is precisely the absence of any person concluding contracts on the enterprise's behalf that places these models beyond the reach of an agency-based nexus rule.

4.2 Why Digital Business Models Resist the Post-BEPS Framework

Every new phrase introduced by BEPS Action 7 to Article 5(5) and 5(6) still assumes a person in the source state whose conduct is the proximate cause of the conclusion of contracts,

[297] OECD, Action 1 (n 1), pp 55-64.
[298] Ibid, pp 100-101.
[299] Jean Charles Rochet and Jean Tirole, 'Platform Competition in Two-Sided Markets' (2003) 1 *Journal of the European Economic Association* 990, 990–991.
[300] Ibid.
[301] Karl Täuscher and Sven Laudien, 'Uncovering the Nature of Platform-based Business Models: An Empirical Taxonomy' (2017) *Proceedings of the 50th Hawaii International Conference on System Sciences* 5285, 5286.
[302] Andrei Hagiu and Julian Wright, 'Multi-Sided Platforms' (2015) 43 *International Journal of Industrial Organization* 162, 162–163.

and in a fully automated model, there is no such person.[303] This core structural reason is why the revised agency rule fails to reach digital and platform-based business models.[304] Read against digital and platform-based models, each of these revisions operates within the same premise and leaves it untouched. "Habitually concludes contracts" and "habitually plays the principal role leading to the conclusion of contracts" both require a *person*, within the meaning of Article 3(1)(a), whose activity can be located in the source state and characterised; the replacement of a formal test with a functional one expands *what that person may do* without affecting the antecedent requirement that a person has to do it.[305] A marketplace platform, as defined in the preceding section, supplies the framework within which independent users transact but does not itself conclude contracts on the enterprise's behalf, and the matching of supply and demand is performed by software rather than by any person playing a principal role.[306] The same is true for the narrowed independent-agent exception: Article 5(6) requires an agent whose dependence must be evaluated, and in cases where contracts are created using an automated interface, neither an independent nor a dependent agent can be included in or excluded from the exception, as assessing the dependence of an algorithm can be extremely difficult.[307] The consequence is that the digital platform does not avoid the agency rule through an artificial arrangement, in the sense criticised in Chapter 3, on the other hand, it falls outside the rule's scope altogether. This is the precise point at which the analytical vocabulary of "artificial avoidance" loses its impact: there is no artifice to dismantle where the connecting factor the rule looks for is simply not there.[308] As mentioned, some scholars anticipated that automated contracting satisfies almost every substantive element of the agency permanent establishment except the one the reform never revisited, that the agent must be a person rather than a machine.[309]

As a result, for these purposes Action 7 was targeted incorrectly. The reform accomplishes its stated goal in relation to physical-economy avoidance structures, commissionaire arrangements, contract splitting, and the fragmentation of activity across

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[303] OECD, *BEPS Action 7* (n 17), Article 5(5) –(6); Eisenbeiss (n 16), p 501-502.
[304] Ibid.
[305] OECD Model (2017) (n 6), Article (5), Article 3(1)(a);
[306] Täuscher and Laudien (n 301), p 5286; Rochet and Tirole (n 299), p 990.
[307] OECD, *BEPS Action 7* (n 17), pp 23-26.
[308] European Parliament, *Impact of Digitalisation on International Tax Matters: Challenges and Remedies* (Study for the ECON Committee, PE 626.078, 2019), pp 28-29.
[309] Skaar, 'Erosion of the Concept of Permanent Establishment: Electronic Commerce' (n 286), p 193.

connected organizations.[310] However, as compared to the digital economy, its scope is much more constrained: commentators have observed that the revised provisions arguably expand taxable nexus only by capturing certain forms of previously excluded physical presence, which is the opposite of what highly digitalised models need.[311] According to the literature's broader assessment, Action 7 and the transfer-pricing work of Actions 8 to 10 do not sufficiently address the taxation of digital platforms and companies that supply goods and services into a jurisdiction with limited or no permanent establishment there.[312] Moreover, a challenge that has been consistently identified about the agency PE and fixed place PE rules, is that they do not function well with platform-based business models because activities conducted digitally require no physical presence in the source State, and because Article 5 does not extend to virtual activity carried on without such presence.[313] Consequently the resulting income falls to be taxed only in the enterprise's State of residence.[314] The reform thus operates entirely within the inherited architecture of Article 5; it adjusts *who* counts as a dependent agent without revisiting whether dependent agency, or physical presence of any kind, remains the appropriate trigger for source taxation in the first place.

The OECD's treatment of websites and servers shows the continuing dependence of the PE concept on physical presence. A website, as a combination of software and electronic data, cannot itself constitute a fixed place of business because it lacks a physical location.[315] By contrast, the server on which the website is hosted may constitute a fixed place of business where it is located in a specific state and is at the disposal of the enterprise according to the OECD Model commentary since 2003.[316] This distinction shows that, even in the context of digital commerce, the traditional PE framework continues to search for a tangible object capable of being territorially located.[317]

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310 OECD, *BEPS Action 7* (n 17), p 14.
311 Visser and Hidding (n 208), p 31.
312 European Parliament, *Impact of Digitalisation on International Tax Matters* (n 308), pp 28-32.
313 Hermosin Alvarez Montserrat, 'The Permanent Establishment: The Crisis of an Institution in the Digital Economy' in Wolfgang W Kraft and Andreas Striegel (eds), *WCLF Tax und IP Gesprächsband 2019* (Springer Gabler, 2021), p 50-51.
314 Ibid.
315 Requena and González, (n 25), 735-736.
316 OECD Model (2003) (n 156), Commentary on Article 5, para 42-2; Montserrat, (n 313) p 51-52.
317 Requena and González, (n 25) pp 735-736; Ibid.

4.2.1 The Nexus Problem

The OECD talked about the nexus problem in its BEPS Action 1 Final Report and they raised concerns about "the continual increase in the potential of digital technologies and the reduced need in many cases for extensive physical presence in order to carry on business, combined with the increasing role of network effects generated by customer interactions, can raise questions as to whether the current rules to determine nexus with a jurisdiction for tax purposes are appropriate."[318] This nexus problem is exactly presented in the physical permanent establishment, and it is the root of which the agency-rule gap is only one expression. Both limbs of Article 5, the fixed place of business and the dependent agent, tie source taxation to a physical or human connecting factor; the digital economy's defining characteristic, by contrast, is the capacity to generate substantial and sustained revenue from a market jurisdiction with little or no physical footprint, the "scale without mass" phenomenon.[319] This mismatch ultimately comes down to the distribution of taxing powers between the state of residence and the source state, a market jurisdiction may see substantial economic activity and income generation on its territory but be unable to tax it because the connecting factor (nexus) on which Articles 5 and 7 depend is theoretically absent.[320] The agency PE as previously stated, requires a person; neither a website nor the computer hardware supporting it can constitute a permanent establishment because the Commentaries require that an agent must be a legal person.[321] Consequently, the fixity requirement that anchors the fixed-place limb of Article 5 can be eliminated almost at will by an enterprise operating through digital means.[322] When viewed in this context, the aforementioned amendments are seen as a response that operates at the wrong level: Action 7 limited itself to relatively minor changes to Article 5 because the digital economy cannot be meaningfully separated from the economy as a whole.[323] The resulting changes have been described in the literature as less significant than the advancement of the digital economy they were intended to address; they increased the number of permanent establishments without reestablishing the connection between the jurisdiction where value is generated and the jurisdiction entitled to tax it.[324]

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[318] OECD, BEPS Action 1 (n 1), p 99.
[319] OECD, *Tax Challenges Arising from Digitalisation* (2018) (n 4), p 24.
[320] Requena and González, (n 25) pp 733–734.
[321] Ibid, p 738.
[322] Ibid.
[323] Montserrat, (n 313) p 53.
[324] Ibid.

The *French Google Ireland* case provides a specific example of the outcome.[325] Google generated substantial advertising revenue from French customers, yet the Paris administrative tribunal held that Google Ireland had no permanent establishment in France: the local entity, Google France, neither concluded contracts binding the Irish company nor possessed the authority to do so, the final approval of contracts resting with the Irish company managed outside France.[326] It was undeniable that the business earned a substantial amount of money from France, it was the rule's necessary connecting element that was missing, and without it, no taxation right developed.[327]Moreover, a company may have a substantial digital presence in a jurisdiction via internet and a website, but that presence cannot be taxed there, since the OECD Commentaries have held since their 2003 revision that a webpage fails to meet the fixity requirement for a permanent establishment established in Article 5(1).[328] In the agency limb, the same structural gap is even more noticeable. Articles 5(5) and 5(6) requires a person acting on the enterprise's behalf, whether as a dependent agent concluding contracts or as an independent one excluded from doing so.[329] However, in a platform-based business model, the website itself fulfils the role of a commissionaire: contracts are signed via the digital interface rather than by any individual.[330] Since there isn't a person, there can't be an agent, either independent or dependent, and neither provision allows for the creation of a permanent establishment.[331]

4.3 Alternative Nexus Proposals: Significant Economic/Digital Presence

Prior to BEPS Action 7, the OECD gave websites and digitalised business models little consideration as permanent establishments and only gradually began to recognize virtual PEs, which are websites hosted on servers in the source state.[332] A new nexus based on substantial digital presence was recommended in Action 1's 2014 draft, but it was rejected in the final

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[325] *Société Google Ireland Ltd v France*, TA Paris, 12 July 2017, No 1505165/1-1 (one of five parallel judgments of that date), confirmed on appeal in CAA Paris, 25 April 2019, No 17PA03065. The French tax authority's reassessment (approx €1.1 billion for 2005–2010) failed because Google France lacked authority to conclude contracts binding Google Ireland and its activities were preparatory or auxiliary within art 5(4).
[326] Ibid; Mzwandile Ngidi, 'Determining "Permanent Establishment" in the Digital Economy Epoch: A Case for South Africa' (2022) 43 *Obiter* 509, 516–518.
[327] Ibid; *Société Google Ireland Ltd v France* (n 325).
[328] OECD Model (2003) (n 156), Commentary on Article 5, para 42-2; OECD Model (2017) (n 6), Article 5(1); Requena and González, (n 25) p 734.
[329] OECD Model (2017) (n 6), Article 5(5)-(6), Article 3(1)(a).
[330] Requena and González, (n 25) p 738.
[331] Ibid.
[332] Requena and González, (n 25) p 735.

2015 report.[333] Nevertheless, numerous States implemented similar measures domestically, building on prior French (2013) and European Commission (2014) investigations.[334] Against this background, the academic and institutional debate has converged on a single structural insight: if the connecting factor on which Articles 5 and 7 depend is missing in fully digitalised models, the response must operate at the level of the nexus itself rather than at the level of the agent.[335] To do this, two main approaches have been proposed. The first, more conservative route retains the existing architecture of Article 5 and seeks to stretch it, whether by recalibrating the list of preparatory and auxiliary exceptions, by deploying a force-of-attraction clause, or by treating a server or website as a virtual fixed place of business.[336] The second, more creative approach abandons the requirement of physical or human presence altogether and substitutes a new connecting factor based on the enterprise's significant economic or digital footprint in the market jurisdiction.[337] The "significant economic presence" or "significant digital presence" nexus, that responds most directly to the structural gap identified in the previous sections, and it is therefore the principal focus of this sub-section.

The Task Force on the Digital Economy's work under Action 1 is where this strategy had its first idea.[338] A new nexus in the form of a substantial economic presence, a withholding tax on certain digital transactions, and an equalization charge, were all considered in the 2015 Final Report as potential solutions to the larger direct-tax issues of digitalization.[339] However, as already mentioned, the Report declined to implement any of these options, concluding that they were not necessary at that time and that time.[340] However, it specifically allowed States to incorporate them as extra safeguards in bilateral treaties or domestic legislation, as long as existing treaty obligations were upheld.[341] The most ambitious of the three options was the significant-economic presence, which aimed to establish a true taxable nexus that could bring

[333] OECD, *Comments Received On Public Discussion Draft Beps Action 1: Address The Tax Challenges Of The Digital Economy* (OECD Publishing 2014), pp 457-458, 462; OECD, BEPS Action 1 (n 1), pp 16-17.
[334] Pierre Collin and Nicolas Colin, *Task Force on Taxation of the Digital Economy* (Report to the Minister for the Economy and Finance and others, Ministère de l'Économie et des Finances, January 2013); European Commission, *Expert Group on Taxation of the Digital Economy Report* (European Commission 2014).
[335] OECD, BEPS Action 1 (n 1), pp 99–100; Requena and González (n 25) pp 734–735.
[336] Requena and González (n 25) pp 736-737.
[337] Ibid, pp 738-739; Peter Hongler and Pasquale Pistone, 'Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy' (2015) 15 *WU International Taxation Research Paper Series* 1, 22-24.
[338] OECD, BEPS Action 1 (n 1), p 13.
[339] OECD, BEPS Action 1 (n 1) pp 107–113, paras 277–292.
[340] Ibid pp 137-142, paras 357–360.
[341] Ibid.

a non-resident enterprise's profits under Article 7, in contrast to the withholding tax and the equalization levy, which function as separate or indirect charges.[342] According to the Task Force's model, a non-resident company would be considered to have a significant economic presence if it consistently generated revenue from a jurisdiction and combined that factor with one or more other digital factors that demonstrated a deliberate and ongoing engagement with the jurisdiction's economy.[343] These factors include the presence of a local user base and the data input that goes along with it, the amount of digital content that comes from the jurisdiction, billing and collection in local currency or using a local form of payment, the upkeep of a website in the local language, accountability for the final delivery of goods to customers, and the provision of ongoing marketing and sales-promotion activities aimed at drawing in customers, consequently platform-based business models would fall under this description.[344] The additional factors were meant to do exactly what physical presence does in the traditional permanent establishment, namely, to demonstrate a level of economic presence that justifies source taxation and the revenue factor alone was deemed insufficient because it would not, by itself, demonstrate a regular and purposeful participation in the jurisdiction's economic life.[345]

Detailed scholarly suggestions mirrored and, in some ways, preceded these institutional proposals. The most significant is the one created by Hongler and Pistone, who suggested adding a new clause to the OECD Model that would create a permanent establishment based on digital presence, backed by a revision of the benefit principle tailored to the digital economy.[346] In order to prevent minor market participation and restrict the growth of small permanent establishments, their proposal would limit the new nexus to a specific set of digitally supplied services and subject it to quantitative thresholds, such as a minimum number of contracts concluded with local users or a minimum level of revenue.[347] Gómez Requena and Moreno González developed a similar, although more conservative, suggestion to change Article 5(1) of the OECD Model to include a nexus based on "significant digital presence" in conjunction with an "economic presence" criterion.[348] According to these authors, an

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342 Requena and González (n 25) pp 736-739; Aleksandra Bal and Carlos Gutiérrez, 'Taxation of the Digital Economy' Chapter 9 in M. Cotrut (ed 1), *International Tax Structures in the BEPS Era: An Analysis of Anti-Abuse Measures* (IBFD, 2015), p 264.
343 OECD, BEPS Action 1 (n 1) pp 107–110, paras 277-284.
344 Ibid pp 108-110, paras 279-284; Requena and González (n 25) pp 738-739.
345 OECD, Action 1 (n 1) p 107, para 278; Requena and González (n 25) p 739.
346 Hongler and Pistone (n 337) pp 19-24.
347 Ibid pp 22-24; OECD, BEPS Action 1 (n 1) p 110, para 284 (need for quantitative thresholds to avoid capturing minor market participation).
348 Requena and González (n 25) pp 737–738.

enterprise's mere existence in cyberspace does not provide a strong enough foundation for taxation on its own unless it is accompanied by an aggregate economic presence, namely, specific quantitative thresholds expressed in terms of the amount of online revenue generated in the source State.[349] Overall, the qualitative indicators proposed for identifying a significant digital presence attempt to translate the intangible reality of a digital business into objectively verifiable criteria: a local domain name, local-language content, local payment options, the number of registered customers and digitally concluded contracts, and the volume of data collected from local users.[350]

However, there are two layers of critics to these nexus proposals. The first is practical: the attribution of profit to any variation of the significant-presence nexus is the main obstacle, not the nexus itself.[351] Some scholars have argued that how to calculate the profit attributable to a digital presence remains unanswered, because the authorised OECD approach attributes profit by reference to functions performed, assets used and risks assumed, yet a significant-presence nexus arises precisely in the absence of those people, functions and assets.[352] As a result, proponents are pushed into fractional apportionment or a predetermined market allocation, which would reinstate the non-neutrality between traditional and digital businesses that the OECD cautioned against while opposing ring-fencing.[353] The second criticism is more conceptual: the notions of "economic allegiance," "benefit principle," and "value creation" that underpin the nexus are too ambiguous for the allocative goal.[354] Moreover there is no consenus on the definition of "value creation" and it may refer to different factors, including where employees are located, where sales take place, where production occurs, where management decisions are made, or where capital is raised.[355] According to Schön, "economic allegiance" is a "fuzzy concept" that applies to any taxpayer conducting business in a nation and, while it may establish a true link in general, it is unable to identify how to divide income among multiple countries that are equally linked.[356] As a result, the digital-presence test may simply

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349 Ibid, p 736, 738-739.
350 Requena and González (n 25) p 738.
351 Ibid, p 735.
352 Bal and Gutiérrez (n 342), p 264; OECD, *2010 Report on the Attribution of Profits to Permanent Establishments*, (OECD Publishing, 2010), Part I, para 10-15.
353 Wolfgang Schön, 'Ten Questions About Why and How to Tax the Digitalized Economy' (2017) 11 *Working Paper of the Max Planck Institute for Tax Law and Public Finance* 1, 25-26; OECD, BEPS Action 1 (n 1) p 11.
354 Ibid, Schön, pp 19-20.
355 Betty Andrade, 'Developing Countries and the Proposed Article 12B of the UN Model:Some Known Unknowns' (2021) 2021 *International Tax Studies* 2, 6.
356 Ibid.

replace the physical-presence threshold with another unclear one based on economic connection.[357] If this threshold is set too low, it could create too many taxable presences, leading to double taxation risks and higher compliance costs.[358]

For the purposes of this thesis, however, the decisive question is not whether the significant-presence nexus is workable in the abstract, but whether it answers the specific problem this chapter has identified in the agency PE rule. A digital-presence nexus is attractive because it moves away from the traditional structure of Articles 5(5) and 5(6), which depend on the existence of a person acting in the source state, such as a dependent agent or an independent agent. Instead, it bases taxable presence on measurable factors such as revenue, number of users, and data collected in the market jurisdiction.[359] The need to create a completely new connecting factor shows that the post-BEPS agency rule cannot be stretched to reach platform-based models in which no individual plays the primary role leading to the conclusion of contracts, which confirms rather than closes the previously identified gap.[360] Additionally, the proposals conflicts with the terminology of "artificial avoidance" that drives Action 7, whose solution is to examine an agent's behaviour in its true form.[361] A fully automated platform does not fit easily within this logic. There is no artificial arrangement involving a person that can be recharacterized, because the element the agency PE rule looks for, human conduct in the source state, is simply missing.[362] Therefore, the significant-digital-presence nexus does not reinforce the approach taken by BEPS Action 7. Instead, it suggests that Action 7 may have focused on the wrong problem. While Action 7 targets the artificial manipulation of existing nexus rules, digital business models reveal a more fundamental difficulty, namely that the traditional nexus criterion itself may be outdated. To that extent, a digital-presence test, no matter how well-designed, functions as a parallel regime alongside Article 5 rather than a remedy for the structural limitations of the agency rule.[363] This conclusion sets up the comparison with the UN Model Convention's approach that is carried out in the following section.

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[357] Schön (n 353), pp 19-20; OECD, BEPS Action 1 (n 1) p 110, para 284.
[358] Ibid.
[359] OECD Model (2017) (n 6), Article 5(5)-(6) and Article 3(1)(a); Requena and González (n 25) p 738; Hongler and Pistone (n 337) pp 22-24.
[360] Skaar, 'Erosion of the Concept of Permanent Establishment: Electronic Commerce' (n 286) pp 192–194; Eisenbeiss (n 16) pp 501-502.
[361] OECD, *BEPS Action 7* (n 17), pp 15-18; see Chapter 3 above.
[362] European Parliament, *Impact of Digitalisation on International Tax Matters* (n 308), pp 28-29; Eisenbeiss (n 16) p 493.
[363] Requena and González (n 25) p 738; OECD, Action 1 (n 1) pp 137-142.

4.4 The UN Model Convention's Approach to Agency PE and Digital Nexus

In contrast to the OECD Model, the UN Model has historically prioritized protecting the source state's taxing rights, particularly in agreements between rich and developing nations.[364] This distinction is clear in Article 5.[365] The UN Model includes more expansive source-state regulations, such as a services PE, a shorter construction PE threshold, a dependent-agent rule based on the upkeep and delivery of stock, and a unique rule for insurance companies, even though the fundamental definition of permanent establishment is still based on a fixed place of business.[366] Article 7 of the UN Model also contains a limited force-of-attraction rule, allowing the source state to tax certain sales or similar business activities that are not strictly attributable to the PE itself.[367]

These discrepancies demonstrate that the UN Model is typically more inclined than the OECD Model to defend taxation in the market state.[368] This is also relevant to the current thesis because it illustrates a different policy balance: the OECD Model has historically been more restricted in permitting source-state taxes, whereas the UN Model places more emphasis on the revenue interests of source countries.[369] The UN agency PE rule does not, however, resolve fully the issue of digital nexus because of its more expansive source-state orientation.

The UN Model's Article 5(5)(a) core agency rule now mostly adheres to the post-BEPS OECD phrasing.[370] It is applicable when an individual working on behalf of a business routinely closes contracts or regularly plays a key role in closing contracts that are routinely concluded without the business making significant changes.[371] The UN Model and BEPS Action 7 have the same fundamental reform logic in this regard. The behaviour of an individual in the source state and their contribution to the foreign enterprise's contracts continue to be the main focus.[372] However, there is an extra agency PE rule in the UN Model that is absent from the OECD Model. A PE may occur under Article 5(5)(b) if an individual routinely keeps a

[364] United Nations, *Model Double Taxation Convention between Developed and Developing Countries 2021* (United Nations 2021).
[365] Ibid, Article 5.
[366] Michael Lennard, 'The UN Model Tax Convention as Compared with the OECD Model Tax Convention – Current Points of Difference and Recent Developments' (2009) *Asia-Pacific Tax Bulletin* 4, 4-7.
[367] UN Model 2021 (n 364), Article 7.
[368] Lennard (n 366), p 4.
[369] Ibid; UN Model (n 364), para 3.
[370] UN Model 2021 (n 364), Article 5(5)(a).
[371] Ibid.
[372] UN Model 2021 (n 364), Article 5(5)(a); Lennard (n 366), p 4.

stock of goods or merchandise in the source state and delivers those goods or merchandise on behalf of the company.[373] This clause, which is obviously more source-oriented, can be pertinent in distribution arrangements where local delivery services facilitate market sales.[374] However, the structural issue mentioned in the earlier sections is not addressed. The rule, which is based on tangible products and stock, still relies on an individual acting in the source state.[375] For entirely digital or platform-based enterprises, where the pertinent market interaction occurs through software, user interfaces, and data rather than local inventories, it is therefore less relevant.[376]

The same limitation can also be seen in the independent-agent rule of Article 5(7), which excludes agents acting in the ordinary course of their own business, but denies independent-agent status where a person acts exclusively or almost exclusively for closely related enterprises, similarly to the OECD Model.[377] By making it more challenging for multinational corporations to rely on nominally distinct group agents, this supports the source-state stance. But the analysis is still person-based, with the question of whether an individual is dependent or independent remaining.[378] Additionally, the UN Model maintains a deemed insurance PE in Article 5(6), which treats an insurance company as having a PE when it collects premiums or insures risks in the source state through a non-independent person, a circumstance that would not necessarily result in a PE under the OECD Model.[379] Although these extensions in the UN Model expands the category of human or physical presence that triggers source taxation, a fully automated platform that concludes contracts through a digital interface still fall outside the UN agency rule for the same structural reasons that it did in the OECD Model.[380]

Considering this, the importance of Article 12B becomes clear.[381] The UN Tax Committee approved Article 12B for inclusion in the 2021 UN Model after realizing that neither the agency PE nor the fixed-place PE could achieve substantially digitalized models

373 UN Model 2021 (n 364), Article 5(5)(b); Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle* (n 29), Ch 35, p 793.
374 Lennard (n 366), p 6-7.
375 UN Model 2021 (n 364), Article 5(5)(b); Article 3(1)(a).
376 OECD, Action 1 (n 1), p 11.
377 UN Model 2021 (n 364), Article 5(7).
378 Ibid; Richard J. Vann, 'The UN Model and Agents: "Wholly or Almost Wholly"' (2011) 62 *Sydney Law School Legal Studies Research Paper* 1, 1-3.
379 UN Model 2021 (n 364), Article 5(6); Lennard (n 366), p 6.
380 Eisenbeiss (n 16) pp 501-502; Skaar, 'Erosion of the Concept of Permanent Establishment: Electronic Commerce' (n 286), pp 192-194.
381 UN Model 2021 (n 364), Article 12B.

and that the OECD's Pillar One was too complicated.[382] Article 12B allows a contracting state to tax income from automated digital services (ADS) paid to a resident of the other contracting state in the absence of any permanent establishment, fixed base, or minimum duration of presence in the source state.[383] "Automated digital services" are defined as services provided over the internet or an electronic network requiring minimal human involvement from the provider, with a non-exhaustive list in Article 12B(6) which includes online advertising, the supply of user data, online search engines, online intermediation platforms, social media, digital content, online gaming, cloud computing, and standardised online teaching.[384] The beneficial owner may choose to use a net "qualified profits" basis instead of the mechanism, which is a withholding tax on the gross payment at a bilaterally negotiated rate (the Commentary recommends 3% or 4%).[385] It is necessary to note that Article 12B does not introduce a new nexus nor modify the PE definition; where a PE or fixed base exists and the services are effectively connected to it, Article 7 still prevails.[386] By basing the taxation right on the source of the payment, the payer's home or PE, rather than on the provider's presence, the provision avoids altering the linking element.[387] Compared to the significant-presence ideas discussed in section 4.3, which attempted to recreate a nexus inside Article 5, Article 12B deviates more drastically from the architecture of Articles 5 and 7 of the OECD Model; yet, it still refuses to engage the agency rule at all.

Article 12B has also been criticised in ways that are directly relevant to this thesis. Báez Moreno argues that the provision is unnecessary and may even create further problems.[388] In his view, the issue that Article 12B tries to solve results from an overly narrow interpretation of Article 12A on fees for technical services.[389] If Article 12A was interpreted more broadly, it could already cover automated digital services.[390] The introduction of a separate rule for automated digital services may therefore suggest that these services were not covered by

382 John W. Mpoha, 'Article 12B of the UN Model (2021): ASimplified Solution for Developing Countries to Tax Income from the Digital Economy?' (2022) 76 *Bulletin for International Taxation* 228, 228; Andrés Báez Moreno, 'Because Not Always B Comes after A: Critical Reflections on the New Article 12B of the UN Model on Automated Digital Services' (2021) 13 *World Tax Journal* 501, 502.

383 UN Model 2021 (n 364), Article 12B(1)-(2); Báez Moreno (n 382), p 501.

384 UN Model 2021 (n 364), Article 12B(5)-(6); Mpoha (n 382), p 233-234.

385 UN Model (2021) (n 364), Article 12B(2)-(3); UN Model (2021) (n 364), Commentary on Article 12B, para 28; Mpoha (n 382) p 233.

386 Mpoha (n 382) p 234; UN Model (2021) (n 364), Article 12B(8).

387 Ibid; UN Model (2021) (n 364), Article 12B(9).

388 Báez Moreno (n 382), pp 502, 513.

389 Ibid.

390 Báez Moreno (n 382), pp 504-513.

Article 12A in the first place.[391] This creates a possible "spillover" effect: even in treaties that do not include Article 12B, courts may reason that automated digital services fall outside a technical-services clause, simply because a separate provision was later introduced to tax them.[392]

Mpoha created a second set of objections that focus on the workability of the Article.[393] Characterization disputes and double taxes are encouraged by the unclear definition of "minimal human involvement" and its boundary with the customized services that are still covered by Article 12A.[394] The most severe are the enforcement challenges in business-to-consumer contexts, which Article 12B, unlike Article 12A, does not exclude: Mpoha considers it unfeasible for individual consumers to withhold, identify the beneficial owner, and apply the appropriate treaty rate.[395] This is made worse by the source rule, which links the taxation right to the payer's location rather than the user's, enabling a business to locate the payer in a low-tax jurisdiction while still reaching users in the market state.[396] Moreover, both authors come to the conclusion that the provision's yield for developing nations is probably low and that its shortcomings outweigh its advantages.[397]

In conclusion, since Article 12B does not change Article 5 or Article 7, the nexus issue remains unresolved: it is a workaround rather than a remedy.[398] In response to the automated business model, the UN chose to circumvent the PE threshold by imposing a withholding tax on payments rather than improving the dependent-agent test, which it most likely could have probably been attempted in its source-favourable form.[399] The underlying vulnerability to artificial avoidance remains because Article 5 is left unchanged; an organization that organizes its operations to avoid the agency PE falls outside of it, and Article 12B's payer-based sourcing creates a second way to arrange payment flows to escape the source state.[400] That choice is the strongest available confirmation that the agency rule, in both its OECD and its UN form, cannot reach models in which no person plays the principal role leading to the conclusion of contracts.

[391] Ibid.
[392] Ibid.
[393] Mpoha (n 382) p 236.
[394] Ibid; Báez Moreno (n 382) pp 516-519; UN Model (2021) (n 364), Article 12A.
[395] Mpoha (n 382), p 236-237.
[396] Ibid; UN Model (2021) (n 364), Article 12B (9).
[397] Mpoha (n 382), p 239; Báez Moreno (n 382) p 502.
[398] Mpoha (n 382), pp 237-238.
[399] Báez Moreno (n 382), p 502.
[400] Mpoha (n 382), pp 237-238.

It also frames the question to which the next section turns: whether the post-BEPS agency rule is sufficient, or whether a complementary nexus standard beyond Article 5 has become unavoidable.

4.5 Is BEPS Action 7 Sufficient, or Is a New Standard Required?

This chapter's analysis allows for a somewhat direct answer to the thesis's research question. The digital economy necessitates a complementary nexus rule beyond Article 5 OECD since the revised agency permanent establishment rule under BEPS Action 7 does not effectively prevent the artificial avoidance of permanent establishment status in digital and platform-based business models.[401] Action 7 is an effective response to the physical-economy avoidance structures it was designed to defeat (commissionaire arrangements), but a misdirected one as against the digitalised models that Action 1 had identified.[402]

The BEPS Action 7 revision of Article 5(5) and (6) did however succeed against the traditional commissionaire: an entity functioning nearly solely for closely related businesses can no longer claim the independent-agent exception, and a Zimmer-type arrangement would now result in an agency permanent establishment, as established in Chapter 3.[403] According to some commentators, the post-BEPS amendments themselves could serve as a model for a virtual permanent establishment, which would be activated once remote digital activity reaches a certain threshold in the market jurisdiction.[404] This perspective holds that no new connecting factor is necessary, just ongoing improvement and faithful application of the reformed rule.[405]

However, this position cannot be supported mainly for two reasons that this Chapter has established. The first is structural. Each limb of the amended rule still requires a person acting in the source state, as defined by Article 3(1)(a) of the OECD Model, whose actions are the direct cause of contracts being concluded; the amendment only increased what that person may do without changing the requirement that a person has to do it.[406] What it tells about the central idea of Action 7 is the deeper point. "Artificial avoidance" presumes a disguised

[401] Eisenbeiss (n 16), pp 492-493, 501-502; BEPS Monitoring Group, *Comments on BEPS Action 7: Revised Discussion Draft on Preventing Artificial Avoidance of Permanent Establishment Status* (BEPS Monitoring Group 2015), p 3.
[402] OECD, BEPS Action 1 (n 1), pp 99-100, 142-143; European Parliament, *Impact of Digitalisation on International Tax Matters* (n 308), pp 28-32.
[403] Eisenbeiss (n 16), p 489; Hoor and O'Donnell (n 212), pp 932-933.
[404] Schön (n 353), p 288.
[405] Ibid.
[406] OECD Model (2017) (n 6), Article 5(5)-(6) and Article 3(1)(a); Eisenbeiss (n 16), pp 501-502.

substance: a coherent action divided into auxiliary pieces and a dependent agent disguised as a commissionaire.[407] The principal-role test and the closely-related-enterprise exclusion are two of the reform's methods for taxing a hidden profit by looking behind its outward appearance.[408] There is usually no such concealment on digital platforms. The lack of a contracting person is just how the company runs; it is not a structure designed to circumvent the rule.[409] Action 7 does not fully address this problem because it was designed to prevent the artificial manipulation of existing nexus rules.[410] The digital economy, however, raises a more fundamental difficulty: the traditional nexus criterion itself may be outdated. The OECD had already acknowledged this distinction in its own Action 1 work, which described the digital challenge as one of nexus and profit allocation rather than base erosion and specifically left a significant-economic-presence nexus to be developed independently rather than integrated into the Action 7 reform.[411]

The second reason is that the alternative nexus described in this Chapter still confirms the gap that the revised agency PE rule left opened. The UN Model's Article 12B (discussed in section 4.4) and the significant digital\economic-presence proposals (discussed in section 4.3) both address the same diagnosis: that the agency rule cannot reach automated models and that the response must function at the nexus level or completely avoid the permanent establishment threshold.[412] It follows that a complementary standard, rather than a replacement of the agency rule, is the appropriate response. The reformed Article 5(5) and (6) retain their value for the substance-light *physical* structures they now capture, and nothing in this analysis suggests they should be dismantled; what they cannot supply is a connecting factor for value generated in a market jurisdiction without any person, agent or fixed place through which it is mediated, the "scale without mass" that defines the digital economy.[413] This thesis argues that the question is no longer whether the agency rule should be supplemented but how the complementary standard should be built.

[407] *Cadbury Schweppes* (n 196); Sumper and Estebanez (n 204), pp 26-27.
[408] Calabrese (n 162), p 136; *BEPS Action 7* (n 17) para 38.8-38.10.
[409] Skaar, 'Erosion of the Concept of Permanent Establishment: Electronic Commerce' (n 286), p 192.
[410] Eisenbeiss (n 16), p 493.
[411] OECD, Action 1 (n 1), pp 99-100, 137-142.
[412] See sections 4.3 and 4.4 above; Requena and González (n 25), p 738; Báez Moreno (n 382), p 502.
[413] OECD, *Tax Challenges Arising from Digitalisation* (2018) (n 4), p 24; Schön (n 353) p 24-26.

The first design choice of this new nexus concerns the *measure* of presence. The qualitative proposals discussed in section 4.3 do not fully resolve the nexus problem. Criteria such as local-language content, registered users, or data volume may show a connection with the market state, but they do not provide a clear threshold for when that connection becomes sufficient for taxation.[414] As a result, they risk replacing one uncertain test with another.[415] According to Schön, the true decision is between a "digital presence" test that looks at the demand side and a "digital investment" test that uses the company's own committed expenditure as an equivalent for source; the latter reintroduces the physical threshold that the digital economy escapes, while the former is manageable but thin.[416] A more transparent approach would be to use a quantitative trigger, such as a sustained amount of revenue earned in the market state.[417] This would provide a clearer threshold than vague qualitative indicators and reflects the direction taken by proposals such as Hongler and Pistone's digital PE model as discussed under section 4.4) and Pillar One's Amount A.[418] The development of Pillar One reflects the same shift. Earlier OECD proposals placed greater emphasis on the idea of user-generated value and user-involvement, but the 2023 Multilateral Convention moved towards a formula based on revenue and profitability.[419] This suggests that, in practice, value creation was too uncertain a concept to determine how taxing rights should be allocated.[420]

The second, more difficult option relates to *attribution*: a nexus is useless if no profit can be attributed to it, and the approved OECD approach is unable to attribute value to a presence that is characterized by the lack of the risks, functions, and assets on which it depends.[421] Thus, the serious proposals use a formula to channel profit to the market. The most advanced is the Oxford Group's Residual Profit Allocation by Income, which taxes "routine" profit where functions take place but transfers "residual" profit to the destination country.[422] Its advantage is the third-party customer's relative immobility, a base far harder to manipulate

[414] Requena and González, (n 25) pp 738; Schön (n 353) p 19-20.
[415] Ibid.
[416] Schön (n 353) pp 24-26.
[417] Hongler and Pistone (n 337), pp 22-24.
[418] OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, (OECD Publishing, 2020), pp 11-12.
[419] Siona Listokin, 'New Rationales for Taxing the Digital Economy: Lessons from the OECD Pillar One Consultations' (2025) 7 *Frontiers in Political Science* 1, 3, 7-8; OECD Inclusive Framework, *Multilateral Convention to Implement Amount A of Pillar One*, October 2023.
[420] Ibid.
[421] See section 4.3 above; Bal and Gutiérrez (n 342), p 264.
[422] Michael P. Devereux and others, 'Residual Profit Allocation by Income' ch 6, in M. P. Devereux and others, *Taxing Profit in a Global Economy* (Oxford University Press 2021), pp 189-190.

than the location of an agent or contracts.[423] In a more simple manner, the Hongler-Pistone upfront allocation achieves a similar outcome.[424] Both approaches accept that, where there is no physical or human market presence to value under the arm's length principle, some formula-based allocation is necessary.[425]This should not be seen as abandoning principle, but as a practical response to the limits of the agency PE rule.[426]

The third choice of design concerns the *level* of operation, where there is a strong argument against unilateralism. Even though Homa is in favour of a digital permanent establishment, she comes to the conclusion that unilateral enforcement is "very risky" due to practical challenges, including geolocation accuracy that is only 50–70% accurate, the burden of data protection, and the need for coordination against double taxation.[427] Her caution is supported by the empirical record: according to the IMF, the digital services taxes implemented by over thirty jurisdictions only generate a small amount of revenue, between 0.01 and 0.02 percent of GDP, while causing trade tension, double taxation, and ring-fencing that would be avoided with a coordinated solution.[428] That is the clear advantage of a treaty-based standard, whether it is Article 12B or Amount A, over the domestic measures that failed to reach a consensus.[429]

Regardless of the outcome of Pillar One, whose Multilateral Convention is still open for signature,[430] its premise supports the main point of this thesis, namely that although BEPS Action 7 did its work well within the frame it was given, closing the commissionaire and fragmentation structures that had defeated the pre-BEPS 2017 rule, it did not fully answer the question this thesis has posed, which lies beyond Article 5.

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[423] Ibid.
[424] Hongler and Pistone (n 337), pp 32-35.
[425] Devereux and others (n 422), p 190; Hongler and Pistone (n 337), p 34.
[426] Ibid.
[427] Tereza Homa, 'The Future of the Digital Permanent Establishment Concept: Challenges and Obstacles' (2024) 34 *Financial Law Review* 1, 7-9, 14.
[428] International Monetary Fund. Fiscal Affairs Dept., and International Monetary Fund. Legal Dept. "International Corporate Tax Reform" *Policy Papers* (*IMF*,2023), p 30 <https://www.elibrary.imf.org/view/journals/007/2023/001/article-A001-en.xml> last accessed 19 June 2026.
[429] Mpoha (n 382), pp 237-238; Andrade (n 355), p 6.
[430] OECD, *Multilateral Convention 2023* (n 419).

5. CONCLUSION

The purpose of this thesis was to determine whether the revised agency permanent establishment rule under BEPS Action 7 effectively prevents the artificial avoidance of permanent establishment status in digital and platform-based business models, or whether the digital economy necessitates a complementary nexus standard beyond Article 5 OECD. That question is addressed in two parts in the previous chapters: although Action 7 is successful in countering the structures it was designed to attack, namely *commissionaire arrangements*, the digital economy does necessitate a complementary nexus because the issue it raises is not avoidance but rather the absence of the connecting factor itself.

The argument was developed in a cumulative way. Chapter 2 set the ground of how the Article 5 OECD works and explained what constitutes a fixed PE and an agency PE, it also established that permanent establishment serves as the entry point for source taxation of business profits. The agency limb of Article 5(5) provides a functional rather than physical nexus, but it has historically been limited by a formalistic interpretation centred on the power to enter into contracts "in the name of" the enterprise.[431] Chapter 3 demonstrated how that formalism was abused before BEPS Action 7: the commissionaire arrangement, which was upheld in *Zimmer* and disputed in *Philip Morris*, allowed a business to avoid the rule by making sure contracts were signed in the agent's own name while maintaining the economic substance of a dependent agent.[432] In response, BEPS Action 7 narrowed the independent-agent exception for closely connected businesses and replaced the formal "in the name of" criteria with the more expansive "principal role" rule, bringing the traditional commissionaire under the scope of the agency rule.[433]

The reformed rule's limitations were then revealed by applying it to digital and platform-based models in Chapter 4. Each of the amended Articles 5(5) and (6) still requires a person, as defined by Article 3(1)(a), whose actions in the source state were the direct cause

[431] See Chapter 2 above; Persico (n 5), pp 67-69; Pleijsier, 'The Agency Permanent Establishment: The Current Definition - Part One' (n 80), pp 177-178.
[432] See Chapter 3 above; *Société Zimmer Limited* (n 219); *Italian Ministry of Finance v Philip Morris* (n 144); Pleijsier, 'The Artificial Avoidance of Permanent Establishment Status : A Reaction to the BEPS Action 7 Final Report' (n 15), p 444.
[433] OECD Model (2017) (n 6), Article 5(5)-(6); Eisenbeiss (n 16), pp 487-489; OECD, BEPS Action 7 (n 17), p 16.

of contracts' conclusion.[434] Instead of getting around the rule, a completely automated platform contracts through software rather than through such an individual. The thesis has made the following crucial distinction: Action 7 was designed to regulate the disguise of a avoidance structure that exists, whereas the digital problem is the absence of the very connecting factor the rule looks for.[435] This argument was reaffirmed by contrasting it with the other alternative proposals. In contrast to the UN Model's Article 12B,[436] which completely avoids the permanent establishment threshold and taxes the payment for automated digital services through a withholding mechanism keyed to the payer's location, the significant-economic-presence proposals reconstruct a nexus inside Article 5 by replacing physical presence with a digital or economic footprint.[437] Neither approach address or complies with the agency rule, and the fact that they diverge shows that the rule cannot be extended to automated models: one way forgoes the agent in favour of a new linking element, while the other completely ignores the nexus question.

From this the thesis tried to develop its answer to the research question. Since the authorized OECD approach cannot value a presence defined by the absence of functions and assets, a complementary nexus standard must be designed based on three options: a quantitative trigger keyed to sustained revenue rather than the ambiguous language of "value creation"; an attribution rule that routes a share of profit to the market jurisdiction by formula; and a multilateral rather than unilateral footing, given the enforcement and double-taxation hazards that uncoordinated measures generate.[438] The OECD's Pillar One, which separates a market jurisdiction's taxing right from physical presence and keys it to a revenue threshold, embodies that direction of motion.[439]

As a result, the main answer to this thesis research question can be expressed in the following way. BEPS Action 7 is adequate for the avoidance structures of the physical economy that is designed to address, namely commissionaire arrangements, fragmentation of

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[434] OECD Model (2017) (n 6), Article 5(5)-(6) , Article 3(1)(a); Eisenbeiss (n 16), pp 501-502.
[435] Skaar, 'Erosion of the Concept of Permanent Establishment: Electronic Commerce' (n 286), p 192; European Parliament, *Impact of Digitalisation on International Tax Matters* (n 308), pp 28-29.
[436] See section 4.3 above; Hongler and Pistone (n 337), pp 24-25; Requena and González (n 25), pp 737-738.
[437] See section 4.4 above; UN Model 2021 (n 364), Article 12B; Báez Moreno (n 382), pp 501-502 ; Mpoha (n 382), pp 237-238.
[438] See section 4.5 above; Schön (n 353), pp 19-20, 24-26; Devereux and others, *Taxing Profit in a Global Economy* (n 422), p 190; Homa (n 427), pp 7-9.
[439] OECD, *Multilateral Convention 2023* (n 419).

activities and other similar strategies. However, it is inefficient for the digital ones, not because it was poorly drafted, but rather because it was based on an incorrect premise. A regulation that imposes source taxation on an individual or location inside the market state is unable to apply to businesses whose existence is genuine, persistent, and significant but that is solely mediated by data and automated interfaces, and not by a physical agent. Conceived as a substitute for true economic presence, the permanent establishment criterion has evolved into a threshold that the digitalized firm might choose to meet or avoid at will, making a supplementary requirement beyond Article 5 inevitable.

It is important to recognize this study has two limitations. First, its approach is doctrinal and policy-oriented rather than empirical; it does not model the distributional effects of the alternative standards it evaluates or quantify the revenue at stake in any jurisdiction; additionally, its assessment of those standards is inherently provisional given the unresolved status of the multilateral negotiations. Second, it is purposefully limited to the permanent establishment of the agency limb of Article 5 OECD and the nexus question; it does not address the profit-attribution issue in technical detail, viewing it as the primary barrier to any new standard without providing the allocation formula that this barrier requires.

These limitations highlight the most beneficial avenues for future investigation. Particular attention should be paid to the attribution question: Even if a new digital nexus is accepted, it remains unclear how profits should be allocated to the market state. Additional research is still required on other approaches, such as upfront market allocation, fractional apportionment, and residual profit allocation. In reality, the success of any digital nexus may depend more on whether a practical approach to profit attribution can be reached than on how “presence” is defined. The practical enforceability of a quantitative nexus should also be investigated in future studies. This covers issues such whether it is possible to reliably locate users using geolocation tools, whether revenue can be derived effectively, and whether gathering and measuring user data raises data protection issues.[440] More empirical and practical study is needed to address these problems than this doctrinal theory can offer. Finally, the quick development of AI-driven business models, where value is produced from localized user inputs with even less human or physical presence than current platforms, is

[440] Homa (n 427), pp 7-10.

likely to intensify every tension this thesis has highlighted and provide a rich environment for the next steps of the research.[441]

[441] Alessia Fidelangeli and Federico Galli, 'Artificial Intelligence and Tax Law: Perspectives and Challenges' (2021) 4 *CERIDAP* 24.

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