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The Arrival of the New BEPS PE Clause in Actual Tax Treaties via the MLI: Impact, Risks and Need for Further Regulatory Changes (Particular Focus on Spain)

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The present article seeks to analyse the overall potential impact that the new permanent establishment (hereinafter PE) concept that has emerged from the Base Erosion and Profit Shifting (hereinafter BEPS) Project is expected to have as it is gradually incorporated into actual tax treaties worldwide by using Spain as an illustrative example. Firstly, the role that the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (hereinafter MLI) is playing in the implementation of the new rule in tax treaties will be analysed (section 1). Secondly, the wording and scope of the new PE clause will be scrutinized, highlighting its obvious resemblance to ideas foreseen in both prior versions of the Commentaries to the Organization for Economic Cooperation and Development Model Convention (hereinafter OECD MC) and certain domestic administrative resolutions and judgments (e.g., the 'Spanish PE approach', a doctrine widely held by the Spanish tax administration and some courts advocating for a singular interpretation of the PE clause and the rules attributing profits to it) (section 2). Thirdly, there will be an attempt to advance the effects of the arrival of the new clause in actual tax treaties in terms of the expected volume of affected treaties, the expected reaction of tax administrations and courts (in respect of unaffected treaties keeping the classic version of the PE concept), the potential coexistence between the new treaty PE rule and current domestic PE rules and, lastly, the expected (extra) tax revenues for jurisdictions hosting these new forms of PEs (section 3). The intention throughout the contribution is to portray the risks derived from the implementation of this new rule and the need for further regulatory modifications to counteract such risks. Finally, some final remarks will be put forward (section 4).

Keywords: permanent establishment, BEPS project, multilateral instrument, dependent agent, commissionaire arrangements, preparatory and auxiliary activities, attribution of profits to permanent establishments, Spanish tax law, Spanish PE approach.

1 The MLI as a Relatively Effective Tool for a Swift Implementation of BEPS Treaty Measures and the Spanish National Position Towards It

The new concept of permanent establishment (hereinafter PE) that emerged from the Base Erosion and Profit Shifting (hereinafter BEPS) Project along with the rest of the BEPS measures with an impact on bilateral tax treaties[1] has definitely found a good ally in the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (hereinafter MLI).[2] The MLI is a multilateral treaty signed and ratified by 100 and seventy-nine jurisdictions, respectively,[3] that seeks a swift and systematic update of the global tax treaty network (potentially, more than 3,500 tax treaties) by eluding the arduous and never-ending task of bilaterally renegotiating each treaty ad hoc.

Contrary to what its denomination may suggest, the advent of the MLI does not involve overcoming the bilateral paradigm in international taxation at all. It does not directly amend (and much less repeal) covered treaties. Instead, the MLI and pre-existing tax treaties will simply coexist in parallel with the peculiarity that the former would effectively 'modify' the way that the relevant clauses (Article 5 in this case) of covered treaties would apply.[4] The absence of the final consolidated binding versions of the treaties as modified by the MLI portends

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1 Measures deriving from Action 2 (hybrid mismatches), Action 6 (prevention of tax treaty abuse), and Action 14 (mutual agreement procedure). Vid. https://www.oecd.org/tax/beps/beps-actions/ (accessed 18 Mar. 2023).

2 The MLI was adopted on 24 Nov. 2016 and entered into force 1 Jul. 2018 after the deposit of the fifth instrument of ratification, acceptance, or approval. The full text may be accessible here, https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm (accessed 18 Mar. 2023).

3 https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf (accessed 18 Mar. 2023). Three additional jurisdictions (Algeria, Eswatini, and Lebanon) have expressed their intent to sign the MLI.

4 J. Zornoza, *El Convenio Multilateral: un análisis preliminar*, in J. M. Almudí Cid, J. Ferreras & P. Hernández, *El Plan de Acción sobre Erosión de Bases Imponibles y Traslado de Beneficios (BEPS): G-20, OCDE y Unión Europea* 496 (Aranzadi 2017).

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uncertainties as to how the ultimate applicable treaty rules would appear. Uncertainties that have been somewhat addressed by the publication of either databases crossing relevant data (e.g., covered treaties, matching positions)[5] and/or unofficial consolidated synthesized versions combining the original normative text with the options selected by relevant jurisdictions with mere informative (and non-binding) effects.[6]

The MLI affords a significant degree of flexibility[7] that allows interested jurisdictions to (1) select treaties they wish to cover among those of their treaty network, (2) make limited or absolute reservations with regards to clauses that are not considered as minimum standards, and (3) make a choice among a catalogue of normative options. Flexibility has proven to be the major virtue and the primary weakness of the MLI simultaneously. On one hand, the high degree of adaptability to the particular needs of jurisdictions pursuing distinct goals and pertaining to diverse fiscal cultures has undoubtedly been key to its success in terms of the volume of signatories and potential covered treaties. On the other hand, flexibility may result in the MLI being a rather ineffective tool for actually promoting the effective 'modified' application of selected treaties. This is because this requires the simultaneous convergence of the following three conditions: (1) both contracting jurisdictions must obviously sign and ratify the MLI, (2) both contracting jurisdictions must include the treaty in common among the covered ones, and (3) both contracting jurisdictions must refrain from making a reservation on the relevant article (if applicable) and choose an equal (or, at least, compatible) normative option among those allowed by the MLI ('matching position'). As a result, the nonfulfillment of either of these conditions would effectively prevent the tax treaty between both jurisdictions from being affected by the MLI whatsoever. Indeed, later reference will be made to the example of Spain in order to illustrate how the entry into force of the MLI in that country has not generated the expected impact in the PE concept of its treaty network.[8]

The adoption of the MLI is key for a jurisdiction as Spain[9] with one of the largest treaty networks in the world comprising 103 ratified treaties (of which ninety-nine are in force).[10] The MLI formally came into force in 2022 following its ratification, although most of its articles will not generate effects until 2023.[11] In its definitive final position,[12] Spain has shown adherence to most of the treaty measures proposed by the BEPS Project with only limited reservations.[13] In particular, this country has strongly expressed its will to renovate the PE concept in accordance with the guidelines established by Action 7 of the BEPS Project in the terms explained in the following section:

2 A new PE with evident reminiscences of old commentaries to the OECD MC and certain domestic administrative doctrines and case law (Spanish PE approach)

When the Organization for Economic Cooperation and Development (hereinafter OECD) composed the BEPS Action Plan back in 2013, it set out two distinct channels to renovate the PE concept envisaged in the 2014 OECD Model Convention (hereinafter OECD MC) in Actions 1 and 7 with the former representing the revolution of the term and the latter the simple natural evolution of it.

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5 The OECD, as the depositary of the ratification instruments, has published a complete toolkit with the different options and reserves made by all signatory jurisdictions (https://www.oecd.org/tax/treaties/mli-database-matrix-options-and-reservations.htm (accessed 18 Mar. 2023) and a dynamic database that allows selecting two signatory jurisdictions and checking whether their treaties are covered and that their 'matching positions' result in the modification of the relevant provisions of their treaties https://www.oecd.org/tax/treaties/mli-matching-database.htm, (accessed 18 Mar. 2023).

6 These consolidated versions lack binding effects insofar as they have not been properly negotiated, signed, and ratified by both relevant jurisdictions following their respective legislative procedures (i.e., the procedure that the MLI wished to avoid in the first place). This is the case for Austria, Japan, Spain *see* last column, https://www.hacienda.gob.es/es-ES/Normativa%20y%20doctrina/Normativa/CDI/Paginas/CDI_Alfa.aspx), (accessed 18 Mar. 2023), and the United Kingdom.

7 On the multiple reasons why the MLI can be regarded as a flexible tool (and the importance of it), *see* N. Bravo, *A Multilateral Instrument for Updating the Tax Treaty Network* 169–245 (IBFD 2020).

8 Vid., s. 3.1.

9 Spain signed the MLI on 7 Jun. 2017 although it did not deposit the instrument of ratification along with its definite 'national position' until 28 Sep. 2021. The effective entry into force was delayed until Jul. 2022, although most articles (except for those related to mutual agreement procedures) will not generate effects until 2023.

10 https://www.hacienda.gob.es/es-ES/Normativa%20y%20doctrina/Normativa/CDI/Paginas/cdi.aspx

11 This is a direct consequence of Art. 35.7 of the MLI to which Spain has adhered.

12 https://www.oecd.org/tax/treaties/beps-mli-position-spain-instrument-deposit.pdf (English version, accessed 18 Mar. 2023), https://www.boe.es/boe/dias/2021/12/22/pdfs/BOE-A-2021-21097.pdf Spanish version, (accessed 18 Mar. 2023).

13 Among treaty measures derived from Action 2 (hybrid mismatches), Spain adhered to option C as the method to correct double taxation and further reserved its right not to modify the tie-breaker rule to resolve dual residency (a decision that was applauded in E. Escribano, *La corrección de la doble residencia fiscal corporativa en la red española de convenios de doble imposición: sede de dirección efectiva VS. La propuesta (abortada) de BEPS*, in *El tratado Multilateral para aplicar las medidas relacionadas con los tratados fiscales para prevenir la erosión de las bases imponibles y el traslado de beneficio* (J. M. Almudí, J. Ferreras & P. Hernández, Aranzadi 2022, pre-print version, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3929918, (accessed 18 Mar. 2023). As for Action 6 (treaty abuse), Spain solely reserved its right not to adopt the saving clause envisaged in Art. 1.3 of the 2017 OECD MC. Lastly, regarding Action 14, Spain reserved its right: (1) not to allow taxpayers to apply for mutual agreement procedure in any of the contracting states but solely in their residence state, (2) not to make arbitration compatible with a domestic judicial procedure, (3) not to apply arbitration under certain circumstances (anti-avoidance rules and certain tax infringements and crimes), and (4) not to introduce the correlative transfer pricing adjustment (already in place in Art. 9 of the Spanish treaties). Vid. A. Ribes, *La posición española ante el convenio multilateral de la OCDE para prevenir la erosión de las bases imponibles y el traslado de beneficios*, 6 Quincena Fiscal (2018).

Revolution was indeed represented by Action 1. Among the different solutions explored by the OECD to address the tax challenges derived by the digital economy,[14] the proposal for a 'significant economic presence' as a potential new nexus to complement the pre-existing PE clause stood out. The proposal would no longer demand the physical presence of the non-resident taxpayer in the territory concerned. Instead, it would require the presence of a number of alternative factors expressing a significant involvement of the taxpayer with the host jurisdiction (e.g., volume of revenue derived from remote operations with local clients, web with local domain, volume of active users, volume of collected data, inter alia). While this embryo failed to hatch due to the evident lack of political consensus, it provided the perfect fertile breeding ground for a much more mature subsequent proposal, i.e., the 2018 European draft directive on a 'significant digital presence'.[15] This proposal has not yet been discarded as a possible long-term solution in the absence of global agreement on Pillars 1 and 2.

For its part, Action 7 represented the natural evolution of the pre-existing PE concept in order to re-establish the intended effects of the original clause by avoiding its 'artificial' elusion.[16] The use of this adjective by the OECD is far from innocent as it suggests that problems addressed by the report were related to artificial operations conducted by the taxpayers (thus placing us in the realm of tax avoidance) rather than to deficiencies of the own rule. In the authors' view, it seems clear that the vast majority of practices Action 7 dealt with do not qualify as 'artificial' or abusive, at least not according to the Spanish general anti-avoidance rule.[17] Instead, as will become apparent further along in this article, it is believed that concerns incited by the report essentially signal the inherent deficiencies and weaknesses of the rule's wording that has only been minimally modified in the last decades.

Changes to Article 5 proposed by Action 7 cannot qualify as surprising or innovative. Rather, the final report limited itself to codifying pre-existing ideas long present in the Commentaries to Article 5 of the prior versions of the OECD MC and elevating them to the category of potential rule at the level of the text of the model convention. For instance, changes to Article 5.3 reflect concerns already risen by paragraph 18 of the Commentaries to Article 5 of the 2014 OECD MC; changes to Article 5.4 mirror paragraph 24 of the Commentaries to Article 5 of the 2014 OECD MC; new Article 5.4.1 does likewise with paragraphs 27 and 27.1; Article 5.5 with paragraph 32.1; and Article 5.6 with paragraph 38.6.

The commentaries to the OECD MC that were mentioned previously have long been fuelling unorthodox interpretations of the PE clause that struggled with the evident deficiencies of its wording by significantly exceeding its literalness and the possible meaning of its terms when not simply contradicting it blatantly, as the authors will have the opportunity to demonstrate in the present section. What is known as the Spanish PE approach constitutes the most paradigmatic example of this unfortunate tendency. Both the Spanish tax administration and certain domestic courts have been following a controversial interpretation of the PE concept as a reaction to the risks arising from its application for years. An interpretation cannot genuinely be considered as consistent with the literalness of the clause.[18] Spain, however, is not the only example as multiple judicial and administrative decisions taken in other jurisdictions (within and beyond the scope of the OECD) have equally adhered to this pattern.[19]

In light of this, the upgrade of these ideas to the level of the text of the model convention (and subsequently actual tax treaties) should be, at least theoretically, very welcome, as it supposes the most straightforward resolution of the structural problems present in Article 5 via its direct amendment, thus abandoning the questionable interpretative paths unilaterally followed by the jurisdictions mentioned previously.

The present section will subsequently analyse what constitutes the new PE concept that is fostered by BEPS and already (extensively) adopted thanks to the MLI. It undeniably resembles both prior Commentaries

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14 https://www.oecd.org/tax/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report-9789264241046-en.htm (acccessed 18 Mar. 2023).

15 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018PC0147 (accessed 18 Mar. 2023). A critical analysis of the proposal may be found in E. Escribano, *A Preliminary Assessment of the EU Proposal on Significant Digital Presence: A Brave Attempt That Requires and Deserves Further Analysis*, in J. M. Almudí Cid, J. Ferreras & P. Hernández, *Combating Tax Avoidance in the EU: Harmonisation and Cooperation in Direct Taxation* (Wolters Kluwer 2019).

16 https://www.oecd.org/tax/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report-9789264241220-en.htm (accessed 18 Mar. 2023).

17 Article 15 of the General Tax Act.

18 Martín Jiménez shares the author's view on the legal inconsistency between the Spanish position on the PE concept and OECD MC Art. 5 (indeed, he understands that the Spanish tax administration and courts even go beyond the old Commentaries to the OECD MC and the new Commentaries resulting from BEPS) but feels this domestic position is ultimately founded. He suggests that the Spanish tax administration should have instead addressed these tax practices with the domestic GAAR (Art. 15 of the domestic General Tax Act), the legal recharacterization of the transaction (Art. 13 of the act mentioned previously), or by simply disregarding of the restructuring arrangements. *See* A. Martín Jiménez, *The Spanish Position on the Concept of Permanent Establishment: Anticipating BEPS, Beyond BEPS or Simply a Wrong Interpretation of Article 5 of the OECDMC?*, 70(8) Bull. Int'l Tax'n 467–468 (2016).

19 Garbarino analyses multiple judicial decisions within Europe (e.g., Belgium, Denmark, France, Germany, Italy, the Netherlands, Norway, and Switzerland) and beyond (Canada, India, Russia, and the United States) that have been key in shaping evolving perspectives about the PE concept in C. Garbarino, *Permanent Establishments and BEPS Action 7: Perspectives in Evolution*, 47(4) Intertax 368–381 (2019) .

to the OECD MC and the previous interpretation approaches followed by Spain (Spanish PE approach) and other jurisdictions. Similarities that make the new BEPS-style PE clause a sort of self-fulfilling prophecy of the Spanish PE approach[20] and other national interpretation approaches.

2.1 *Construction PE and Anti-fragmentation Clause*

The construction PE was added as complementary fiction to the PE clause insofar as it was doubtful that construction sites or installation projects could, by their own nature, satisfy the temporal and geographical requirements demanded by the fixed place of business general proviso. The special rule explicitly specified that these could be regarded as PEs for tax treaty purposes insofar as they surpassed a certain time threshold (normally, twelve months).

The time threshold has traditionally afforded opportunities for abuse as taxpayers have succumbed to the temptation of dividing their contracts up into several parts with each one attributed to a different related party and covering a period less than twelve months. The purpose of this was to avoid the appearance of a PE in the relevant territory.[21] This is a scenario that has traditionally been addressed by domestic anti-avoidance rules, thus giving rise to the direct infringement of the treaty (treaty override) along with the sacrosanct *pacta sunt servanda* principle envisaged in the Vienna Convention on the Law of Treaties of 1969.

In this context, the BEPS Project chose to address these situations straightforwardly and explicitly at the treaty level itself by means of two alternative means. The first was adopting a special anti-avoidance rule ad hoc via Article 14 of the MLI.[22] This rule would allow the accumulation of the periods of time (each one of them exceeding a minimum of thirty days) during which the taxpayer and other 'closely related enterprises'[23] (tax resident in the same or other states) are performing activities connected with the same building site, construction, or installation project for the sole purpose of applying the relevant time threshold. The second was adopting the general treaty anti-avoidance rule, i.e., the principal purpose test (hereinafter PPT rule).[24] This rule would deny access to the treaty benefit envisaged in Article 5.3 (i.e., restriction to source-based taxation) insofar as one of the principal purposes of the fragmentation of contracts was to obtain such a benefit and granting it would be contrary to the object and purpose of the treaty clause.[25] Thirty percent of the signatory jurisdictions of the MLI have expressed their commitment towards the specific anti-avoidance rule (the anti-fragmentation proviso) while all signatory jurisdictions to date have adhered to the general principal purposes test,[26] either as a stand-alone rule (explicitly or implicitly since this is a residual rule)[27] or in combination with a limitation on benefits clause[28]

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[20] This idea is developed in depth in Martín Jiménez, *supra* n. 18.

[21] Commentaries to Art. 5 of the 2014 OECD MC, para. 18 and 2017 OECD MC, para. 52.

[22] A model rule also envisaged in the Commentary to Art. 5 of the 2017 OECD MC, para. 52: 'For the sole purpose of determining whether the twelve-month period referred to in paragraph 3 has been exceeded, a) where an enterprise of a Contracting State carries on activities in the other Contracting State at a place that constitutes a building site or construction or installation project and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days without exceeding twelve months, and b) connected activities are carried on at the same building site or construction or installation project during different periods of time, each exceeding 30 days, by one or more enterprises closely related to the first-mentioned enterprise, these different periods of time shall be added to the period of time during which the first-mentioned enterprise has carried on activities at that building site or construction or installation project'.

[23] A definition can be found in the new Art. 5.8 of the 2017 OECD MC: 'For the purposes of this Article, a person or enterprise is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person or enterprise shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50% of the beneficial interest in the other (or, in the case of a company, more than 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person or enterprise possesses directly or indirectly more than 50% of the beneficial interest (or, in the case of a company, more than 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise or in the two enterprises'.

[24] Article 29.9 of the 2017 OECD MC and Art. 7 of the MLI.

[25] Commentary to Art. 29 of the 2017 OECD MC, para. 182, example J: 'RCO is a company resident of State R. It has successfully submitted a bid for the construction of a power plant for SCO, an independent company resident of State S. That construction project is expected to last 22 months. During the negotiation of the contract, the project is divided into two different contracts, each lasting 11 months. The first contract is concluded with RCO and the second contract is concluded with SUBCO, a recently incorporated wholly owned subsidiary of RCO resident of State R. At the request of SCO, which wanted to ensure that RCO would be contractually liable for the performance of the two contracts, the contractual arrangements are such that RCO is jointly and severally liable with SUBCO for the performance of SUBCO's contractual obligations under the SUBCO-SCO contract. In this example, in the absence of other facts and circumstances showing otherwise, it would be reasonable to conclude that one of the principal purposes for the conclusion of the separate contract under which SUBCO agreed to perform part of the construction project was for RCO and SUBCO to each obtain the benefit of the rule in paragraph 3 of Article 5 of the State R-State S tax convention. Granting the benefit of that rule in these circumstances would be contrary to the object and purpose of that paragraph as the time limitation of that paragraph would otherwise be meaningless'.

[26] Only the United States and Trinidad and Tobago, which have not signed the MLI, have explicitly stated they wish to implement a detailed LOB with no PPT (an option explicitly allowed as a way to comply with the minimum standard in Art. 7.15.a of the MLI). No signatory jurisdiction has chosen this option. *See* OECD, *Prevention of Tax Treaty Abuse: Fourth Peer Review Report on Treaty Shopping* 14 (2022), https://www.oecd.org/tax/beps/prevention-of-tax-treaty-abuse-fourth-peer-review-report-on-treaty-shopping-3dc05e6a-en.htm (accessed 18 Mar. 2023).

[27] This is the case for Spain which has explicitly adhered to the PPT as a standalone rule.

[28] Mosquera analyses the menu of options for complying with the minimum standard on treaty abuse and comments on the options chosen by the respective states. I. J. Mosquera, *BEPS Principal Purpose Test and Customary International Law*, 33 Leiden J. Int'l L. 745, 758–761 (2020). The actual choice made by each one of the MLI signatories may be consulted here, https://www.oecd.org/tax/treaties/mli-database-matrix-options-and-reservations.htm (accessed 18 Mar. 2023).

2.2 *Exemption of Preparatory and Auxiliary Activities*

Both the general PE clause and the dependent agent PE (hereinafter DAPE) are conditioned by the exclusion foreseen in Article 5.4 for preparatory and auxiliary activities. The rationale for the exclusion is that such activities are low-value adding and thus remote from the actual realization of profits. This therefore complicates the task of allocating profits to the performance of such activities by virtue of current profit attribution rules.[29]

The old Article 5.4 raised a relevant concern that all of the listed activities were automatically excluded from the scope of the PE concept notwithstanding the fact that they could eventually be deemed to be essential for the enterprise or even fully coinciding with its core activities.[30] In such a context, the use by a non-resident taxpayer of a fixed place of business located in a foreign territory as a warehouse that is solely intended to store its own goods could never qualify as a PE (thus excluding source-based taxation) pursuant to Article 5.4.a. This is valid even if the presence of a warehouse and the warehousing capacity were considered as strategic for the business of the taxpayer in the relevant territory or even in cases when the taxpayer is itself dedicated to the warehousing business.

The obvious discontent with the natural outcome of its wording instigated the suggestion in the Commentaries to the OECD MC for an interpretative approach for Article 5.4 that was contradictory to its literalism. The Commentaries indeed suggested making the listed activities subject to an extra condition: their qualification as 'auxiliary and preparatory' in connection with the activity carried out by the taxpayer.[31] This is an extra condition that was certainly absent in the treaty clause that has been implicitly accepted by some Spanish administration and court rulings.[32] On the contrary, other judgments chose to strictly adhere to the treaty clause and dismiss the presence of a PE on the grounds that the relevant activity was explicitly listed in Article 5.4 and notwithstanding its relative relevance in connection with the core activity carried out by the taxpayer.[33]

Once again, Action 7 of the BEPS Project wished to leave behind unorthodox interpretation approaches of the PE clause by enhancing the wording of the clause to straightforwardly deal with its deficiencies. It did so by extending the 'preparatory or auxiliary nature' requirement to all of the activities listed and not listed in paragraphs (a) to (f). This required analysing the nature of the taxpayer´s business to identify the activities that form an essential part of it[34] and those that are of a merely supportive and auxiliary character.[35] Naturally, only the latter would eventually be excluded from the PE clause regardless of its inclusion or not among the listed activities in Article 5.4. One of the reasons behind the proposed amendment was the recognition that the listed activities often constituted core activities, particularly in the e-commerce field.[36]

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[29] Commentary to Art. 5 of the 2017 OECD MC, para. 58.

[30] Article 5.4 of the 2014 OECD MC: 'Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include: a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise; b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery; c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise; d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise; e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character; f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character'.

[31] Commentaries to Art. 5 of the 2014 OECD MC, para. 24: 'The decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole (…) In any case, a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise, does not exercise a preparatory or auxiliary activity. Where, for example, the servicing of patents and know-how is the purpose of an enterprise, a fixed place of business of such enterprise exercising such an activity cannot get the benefits of subparagraph e)'.

[32] Ruling by Tribunal Económico Administrativo Central, 2 Mar. 2016, case 0657/2003, judgment of Audiencia Nacional 496/2011, 9 Feb. 2011, *'Borax'* case, legal argument 9 (the court made explicit reference to this extra requirement by paraphrasing the Commentaries to the OECD MC) and binding resolutions of the General Directorate of Taxes V0433-14, 17 Feb. 2014, V1479-14, 4 Jun. 2014 (the Directorate argued that it could not conclude whether the activity of storing assets had to be excluded from the scope of the PE clause since the social object of the non-resident taxpayer remained unknown, and there was no way to know whether the storage activity was auxiliary in respect of the core activity of the taxpayer) and V1480-14, 4 Jun. 2014 (the Directorate concluded that the activity involving storage of goods should be considered as 'auxiliary' in relation to the core activity carried out by the non-resident taxpayer: financial operations involving sale and repurchase agreement).

[33] Judgment of Audiencia Nacional 2810/2010, 20 May 2010, *'M-Real'* case, legal argument 9. The court concluded that the activities carried out by the claimant in Spain were limited to the storage, packaging, and delivery of the products of the non-resident taxpayer despite of the fact that the core business of the latter involved the international transportation of goods.

[34] Any activity that forms an 'essential and significant part of the activity of the enterprise as a whole' (Commentaries to Art. 5 of the 2017 OECD MC, para. 59).

[35] On one hand, a preparatory activity will be something 'that is carried on in contemplation of the carrying on of what constitutes the essential and significant part of the activity of the enterprise as a whole. Since a preparatory activity precedes another activity, it will often be carried on during a relatively short period, the duration of that period being determined by the nature of the core activities of the enterprise' (Commentaries to Art. 5 of the 2017 OECD MC, para. 60). On the other hand, an auxiliary activity 'generally corresponds to an activity that is carried on to support, without being part of, the essential and significant part of the activity of the enterprise as a whole. It is unlikely that an activity that requires a significant proportion of the assets or employees of the enterprise could be considered as having an auxiliary character' (Commentaries to Art. 5 of the 2017 OECD MC, para. 60).

[36] OECD, *Preventing the Artificial Avoidance of Permanent Establishment Status* (Action 7: final report) 10 (2015).

The new Article 5.4 of the 2017 OECD MC modified the previous version as follows while Article 13 of the MLI allowed interested jurisdictions (specifically, 61% of the signatory ones)[37] to swiftly implement such a change in their treaty network:

> 4. Notwithstanding the preceding provisions of this Article, the term 'permanent establishment' shall be deemed not to include:
> *(a)* the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
> *(b)* the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
> *(c)* the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
> *(d)* the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
> *(e)* the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity
> *(f)* the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e) ***provided that such activity or, in the case of subparagraph (f), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.***

Incidentally, Article 5.4.(f) creates an additional concern on its own. This proviso (both the old and the current version) solely allows for the assessment of combinations of (listed or not listed) auxiliary and preparatory activities insofar as they are all conducted in the same fixed place of business. This being the case, taxpayers can easily fragment their preparatory and auxiliary activities in separate and geographically dispersed fixed places of businesses that may well qualify for the PE exemption when analysed separately and in isolation (as explicitly demanded by Article 5.4.(f).[38]

In view of this, the OECD counterattacked once again with its soft law weapon. Its Commentaries invited jurisdictions to make an overall assessment of all the fixed places of business maintained by the taxpayer in the relevant territory, insofar as they form part of a 'cohesive operating business' and perform 'complementary functions' (e.g., receiving and storing goods in one place, distributing those goods through another etc.), for the purposes of concluding whether the combination of activities carried out in them altogether qualifies or not for the preparatory or auxiliary requirement.[39]

The approach mentioned previously afforded jurisdictions the opportunity to interpret this clause in this manner.[40] This was indeed the case for Spain with the '*complex operative settlement*' doctrine followed by both the tax administration[41] and some courts. In the Borax case, for example, the tax administration argued that the non-resident taxpayer, Borax Europe, had a PE in the Spanish territory, as it was using a number of functionally interconnected fixed places of business of its Spanish subsidiary to carry out activities that altogether qualified as a 'complex operative settlement' exceeding what could be deemed as mere 'preparatory and auxiliary'.[42] This conclusion is ultimately shared by both the National Court and the Supreme Court despite not explicitly and strictly following the same argumentation.[43]

The OECD wished to definitively settle all of these concerns at the treaty level by incorporating a new Article 5.4.1 equally foreseen by Article 13.4 of the MLI and followed by 61% of the MLI signatory jurisdictions.[44] The suggested proviso took a step further than the old Commentaries by considering not only the separate but functionally interconnected fixed places of business maintained by the taxpayer in the relevant territory but also

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[37] https://www.oecd.org/tax/treaties/mli-database-matrix-options-and-reservations.htm (accessed 18 Mar. 2023).

[38] Commentaries to Art. 5 of the 2014 OECD MC, para. 27.1: 'Subparagraph f) is of no importance in a case where an enterprise maintains several fixed places of business within the meaning of subparagraphs a) to e) provided that they are separated from each other locally and organizationally, as in such a case each place of business has to be viewed separately and in isolation for deciding whether a permanent establishment exists'.

[39] Commentaries to Art. 5 of the 2014 OECD MC, para. 27.1 *in fine*: 'Places of business are not "separated organizationally" where they each perform in a Contracting State complementary functions such as receiving and storing goods in one place, distributing those goods through another etc. An enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity'.

[40] Judgments of the Italian Supreme Court n. 3367, 3368, and 3369, 7 Mar. 2002; 431926, 26 Mar. 2002; 7682 and 7689, 25 May 2002; 10925, 22 Sep. 2002 and 17373, 6 Dec. 2002, *'Philip Morris'* case. *See* analysis of these judgments in S. Laconte & L. Favi, *A New Definition of Permanent Establishment in Italian Domestic Income Tax Law*, 5(3) Insights 5, 9–10 (2018). According to Mas, this approach did not succeed in jurisdictions other than Italy and Spain; *see* J. Mas, *Acotando el abuso del EP: medidas adoptadas en el marco de BEPS*, 158 Crónica Tributaria 189, 196 (2016).

[41] Binding resolutions of the General Directorate of Taxes V2191-08, V2192-08, 20 Nov. 2008 and V2454-12, 17 Dec. 2012 and ruling by Tribunal Económico Administrativo Central, 15 Mar. 2012, '*Dell*' case. A comment on these administrative resolutions may be found in N. Carmona, *The Concept of PE in the Courts: Operating Structures Utilizing Commission Subsidiaries*, 47(5) Bull. Int'l Tax'n (2013), s. 4.

[42] Judgment of Audiencia Nacional 496/2011, 9 Feb. 2011, 'Borax' case, legal argument 8.

[43] Judgments of Audiencia Nacional 496/2011, 9 Feb. 2011, 'Borax' case and Tribunal Supremo 2680/2014, 18 Jun. 2014, '*Borax*' case. These judgments were analysed by Martín Jiménez, *supra* n. 18, at 459–461 and by Carmona in N. Carmona, *La noción de establecimiento permanente en los tribunales: las estructuras operativas mediante filiales comisionistas*, 145 Crónica Tributaria 39, 46–47 (2012) and in Carmona, *supra* n. 41, s. 5.3.

[44] https://www.oecd.org/tax/treaties/mli-database-matrix-options-and-reservations.htm (accessed 18 Mar. 2023).

those maintained by its 'closely related enterprises'.[45] It did so in order to efficiently address situations in which the taxpayers manage to fragment their preparatory and auxiliary activities not only geographically but also organically.[46]

5.4.1. Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting state and
(a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or
(b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character, provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.

2.3 Agency PE

The agency PE arose in response to the need to allow source-based taxation of business profits in situations when the taxpayer was not engaging in its activities in the foreign territory through a fixed place of business but through a person or number of persons habitually acting in its behalf, which may be regarded as another common modality of effectively carrying a significant business abroad.[47] The contracts linked to the activity of the agent need to be central to the core business and the income-earning process of the taxpayer. This, naturally, excludes those activities considered as preparatory or auxiliary pursuant to Article 5.4.

The old Article 5.5 of the OECD MC explicitly required the agent to have and habitually exercise an authority to '*conclude*' contracts '*in the name of the enterprise*'.[48] The literal wording of the clause made it vulnerable and easily subject to avoidance in the following two scenarios, each one of them were effectively addressed by the OECD with a set of suggested interpretations of the clause that were envisaged in the older versions of the Commentaries to its OECD MC.

The first situation is when agents do not formally conclude the contract but rather limit themselves to substantially negotiate it and further ready it for its authorization, finalization, or signature by the taxpayer itself. In response, the old Commentaries invited jurisdictions to apply the proviso in cases where agents were de facto authorized to negotiate all elements and details of a contract (in a way that was binding on the taxpayer) even if the contract was ultimately signed by another person.[49]

The second situation involves 'commissioners' concluding contracts in their own name and not in that of the principal. This generates a breach between common law and civil law jurisdictions.[50] As for the former, all contracts signed by commissionaires would invariably bind principals irrespective of the name that formally appears on the contract or the fact of whether the principal is disclosed to a third party. The expression 'in the name of' is indeed unknown in common law, and the binding nature of the contract on the principal is always taken for granted. This being so, commissionaires in these territories may always qualify as dependent agents for the purposes of the agency PE clause. As for civil law jurisdictions, by contrast, contracts signed by commissioners in their own name can never technically bind the principal as such. This generates the opportunity for enterprises operating in these jurisdictions to easily avoid the DAPE clause by transforming their agents into commissioners while maintaining the previous *status quo* with a secondary private agreement (principal-commissionaire) according to which the commissionaire would ultimately transfer the effects of the contract with the third party to the principal. Insofar as the intermediation was kept indirect, the commissionaire would never qualify as a DAPE for the purposes of Article 5 thus preventing the relevant (civil law) source state from taxing the profits of the principal linked to those contracts.

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[45] *See* definition in footnote n. 19.

[46] OECD, *supra* n. 36, at 39: 'Given the ease with which subsidiaries may be established, the logic of the last sentence ("[a]n enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity") should not be restricted to cases where the same enterprise maintains different places of business in a country but should be extended to cases where these places of business belong to closely related enterprises. Some BEPS concerns related to Art. 5(4) will therefore be addressed by the rule proposed below which will take account not only of the activities carried on by the same enterprise at different places but also of the activities carried on by closely related enterprises at different places or at the same place. This new rule is the logical consequence of the decision to restrict the scope of Art. 5(4) to activities that have a "preparatory and auxiliary" character because, in the absence of that rule, it would be relatively easy to use closely related enterprises in order to segregate activities which, when taken together, go beyond that threshold'.

[47] B. Arnold, *Permanent Establishment*, in *Global Tax Treaty Commentaries* (P. Pistone, IBFD 2014), s. 1.1.2.2. Arnold argues that the provision was conceived originally as an anti-avoidance rule to prevent taxpayers from planning to avoid the fixed-place-of-business role.

[48] Avery Jones & Lüdicke analyse the origin behind the 'in the name of' expression that surprisingly replaced 'on behalf of' in the agency clause in 1958 probably due to a translation mismatch. *See* J. F. Avery Jones & J. Lüdicke, *The Origins of Article 5(5) and 5(6) of the OECD Model*, 6(3) World Tax J. 203, 218–223 (2014).

[49] Additionally, whenever they did not formally enjoy power of representation; *see* Commentaries to Art. 5 of the 2014 OECD MC, para. 33.

[50] Avery Jones & Lüdicke analyse the different meaning that civil and common law jurisdictions grant to 'agents' and 'commissioners', respectively (Avery Jones & Lüdicke, *supra* n. 48, at 204–209).

Instead, only the (most likely) insignificant commission (adjusted to an arm´s length price if necessary) earned by the commissioner for its indirect intermediation may be taxable by this state provided that the commissioner is deemed to be a tax resident in its territory.

The OECD attempted to address the avoidance of the agency PE clause in civil law jurisdictions by encouraging them to place the emphasis on the fact that the contract was materially concluded on behalf and for the account of the principal irrespective of the fact that they were not signed literally in its name,[51] as the clause otherwise explicitly demanded. The Commentaries to the OECD MC once again proposed innovative interpretations of the PE clause that go well beyond its literal wording. As expected, a number of civil law jurisdictions followed the proposed approach.[52] As for Spain, some administration[53] and court rulings[54] subscribed to the extensive interpretation promoted by the Commentaries by accepting that the key factor for determining the existence of a DAPE was the ability of the contract to de facto bind the taxpayer irrespective of the fact that it was not formally concluded in its name. In particular, the National Court argued that the PE agency clause could not be read as excluding indirect intermediations as those inherent to the commissionaire arrangements envisaged in the code of commerce as this 'could not have been the intention of the clause'.[55] The Supreme Court placed the emphasis not on the contractual link but rather on the functional and factual link between agent and client and the power of the former to effectively bind the latter in the concluded contracts.[56] While these unorthodox interpretations may well be regarded as reprehensible, it is undeniable that they became the only effective tool of civil law jurisdictions for protecting themselves from sloppy tax techniques involving the conversion of agents into commissioners.[57] Nevertheless, other national and foreign courts deviated from the path suggested by the OECD and preferred to adhere to the literal wording of the cause, thereby requiring the actual conclusion of the contract in the name of the represented taxpayer irrespective of other considerations.[58]

Special mention should be made to the paradigmatic *Roche* case ruled by the Spanish National and Supreme Courts that propose a creative and somehow eccentric understanding of the DAPE. The court concludes that the subsidiary of Roche (Swiss entity) in Spain acts as a dependent agent of the latter. It does so not because it has the power to conclude contracts on its name and/or on its behalf (as it lacks such power) but simply because it manufactures goods on its behalf, at its request, and following its instructions. Stated differently, the court understands that the manufacturing activity carried out within Spain is not an activity of the subsidiary as such but one of the own Swiss entity, which allegedly manages the production and human resources located in Spain on its own account, exercises effective control over the activity and eventually bears the risks associated with it. This being the case, the Spanish subsidiary limits itself to following instructions and performing the requested tasks on behalf of the principal without supposedly taking any risks[59] and merely receiving the reimbursement for the direct and indirect costs incurred. More recently, the National Court reached the same conclusion in equivalent cases despite not explicitly referring to the agency clause.[60] The concept of 'industrial' agent followed by these judgments appears to go well beyond the classic conception of a dependent agent with power to conclude contracts envisaged in Article 5.5 of the OECD MC (both the old and the new version) and

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[51] Commentaries to Art. 5 of the 2014 OECD MC, para. 32.1: 'The phrase "authority to conclude contracts in the name of the enterprise" does not confine the application of the paragraph to an agent who enters into contracts literally in the name of the enterprise; the paragraph applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise. Lack of active involvement by an enterprise in transactions may be indicative of a grant of authority to an agent. For example, an agent may be considered to possess actual authority to conclude contracts where he solicits and receives (but does not formally finalize) orders which are sent directly to a warehouse from which goods are delivered and where the foreign enterprise routinely approves the transactions'.

[52] This is the case for Italy; *see* judgments of the Italian Supreme Court n. 3367, 3368, and 3369, 7 Mar. 2002; 431926, 26 Mar. 2002; 7682 and 7689, 25 May 2002; 10925, 22 Sep. 2002 and 17373, 6 Dec. 2002, '*Philip Morris*' case. *See* analysis of these judgments in Laconte & Favi, *supra* n. 40, at 9–10. A more recent judgment of the Italian Supreme Court follows an equivalent approach; *see* judgment n. 3769, 9 Mar. 2012, '*Boston Scientific International*' case and the analysis provided by A. Persiani, *Some Remarks on the Notion of Permanent Establishment in the Recent Italian Supreme Court Jurisprudence*, 40(12) Intertax 675 (2012).

[53] Binding resolutions of the General Directorate of Taxes V2191-08, 20 Nov. 2008; V2192-08, 20 Nov. 2008; V1305-09, 3 Jun. 2009; V2454-12 and V2457-12, 17 Dec. 2012; V0433-14, 17 Feb. 2014 and V1347-15, 29 Apr. 2015, among many others. In all of these resolutions, the Directorate assumed that the mere conclusion of contracts (by the agent) that were binding on the non-resident taxpayer would be sufficient to consider the agency PE irrespective of the name that formally appeared on the contract.

[54] The saga of rulings around the '*Dell*' case constitutes a prime example of the functional approach promoted by the OECD. *See* ruling by Tribunal Económico Administrativo Central, 15 Mar. 2012, 'Dell case', judgment of Audiencia Nacional 2153/2015, 8 Jun. 2015, '*Dell*' case and, ultimately, judgment of Tribunal Supremo 2861/2016, 20 Jun. 2016, 'Dell' case. An analysis of these decisions may be consulted in Martín Jiménez, *supra* n. 18, at 462–467 and Mas, *supra* n. 40, at 202–203.

[55] Judgment of Audiencia Nacional 2153/2015, 8 Jun. 2015, 'Dell' case, legal argument 3.

[56] Judgment of Tribunal Supremo 2861/2016, 20 Jun. 2016, '*Dell*' case, legal argument 5.

[57] Some Spanish authors understand this approach is ultimately justifiable, *see* Mas, *supra* n. 40, at 202, Carmona, *supra* n. 43 and Carmona, *supra* n. 41.

[58] Spain (judgments of Audiencia Nacional 512/2010, 18 Feb. 2010, '*Madex*' case; 2810/2010, 20 May 2010, '*M-Real*' case, 2662/2010, 9 Jun. 2010, '*Madex*' case, 3473/2020, 10 Nov. 2020, '*Nissan*' case), France (judgment of Conseil d´État, 31 Mar. 2010, '*Zimmer*' case) and Norway (judgment of the Supreme Court, 2 Dec. 2011, '*Dell*' case). Some of these judgments were severely criticized by Carmona, *supra* n. 43, at 46, 50–51 and 52 respectively. In *Zimmer* and *Dell*, the courts dismissed the application of the Commentaries to the OECD MC considering that only the conclusion of the contracts explicitly in the name of the taxpayer can effectively bind it under civil law.

[59] Judgments of Audiencia Nacional 248/2008, 24 Jan. 2008, '*Roche*' case and Tribunal Supremo 201/2012, 12 Jan. 2012, '*Roche*' case, legal argument 4. An analysis on these judgments may be consulted in Carmona, *supra* n. 41 at s. 5.4 and Martín Jiménez, *supra* n. 18, at 461–462.

[60] Judgments of Audiencia Nacional 3944/2018, 11 Oct. 2018, '*Honda*' case, legal argument 6 and 1879/2021, 15 Apr. 2021, '*Cadbury*' case, legal argument 5.

the interpretation approaches prompted by their Commentaries. Instead, the courts understood that the agency clause would equally encompass situations in which the agent somehow binds the non-resident taxpayer's participation in the business activity in the state concerned.[61] Fortunately, this approach has not been systematically followed by the Spanish tax administration and courts in other rulings, where they have concluded that the respective Spanish subsidiaries were performing their own economic activities on their own account and bearing the risks associated to those activities irrespective of the natural control exercised by the non-resident parent companies.[62]

The BEPS Project sought to straightforwardly resolve the deficiencies inherent in the wording of the agency PE clause by codifying the approaches already present in the Commentaries and the administrative and judicial national doctrines of some jurisdictions (Spain among them) at the level of the treaty itself. The new Article 5.5 explicitly covers the cases where the agent substantially negotiates the contract on behalf of the principal but does not formally formalize it and the cases where the relevant contract effectively binds the principal and generates material effects on its legal sphere (e.g., obligation to transfer goods or provide services) irrespective of the name that appears in the contract. This new article is gradually making its way in the global tax treaty network through Article 12.1 of the MLI to which 52% of the MLI signatory jurisdictions have adhered.[63]

> 5. Notwithstanding the provisions of paragraphs 1 and 2 ***but subject to the provisions of paragraph 6***, where a person acting ***in a Contracting state*** on behalf of an enterprise and***, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are***
> (*a*) in the name of the enterprise***, or***
> ***(b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or***
> ***(c) for the provision of services by that enterprise,*** that enterprise shall be deemed to have a permanent establishment in that state in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

The new wording of the proviso is expected to finally settle many of the heated discussions around its interpretation but does not completely shield it from tax risks. The amendments mentioned previously do not provide a solution for the risks derived from low-risk distributor arrangements between related parties as explicitly recognized by the OECD itself.[64] Low-risks distributors are those that acquire the products from the non-resident entity to immediately sell them on its own name ('*flash title*'), assuming only minimal risks. The contract between the distributor and the non-resident entity generally relieves the former of most of the functions (inventory management) and risks (debtor risks) that would otherwise be borne by it. The only remaining risks would be those linked to the acceptance of legal title to the products (e.g., transport risks and insurance).[65] Distributors that operate under these circumstances do not fall under the scope of the agency PE clause, either version, as they do not act on behalf of anybody but themselves.[66] However, from a purely economic perspective, commissioners and low-risk distributors are almost alike, thus a massive conversion of the former to the latter is to be expected as the MLI gradually enters into force. The question remains as to whether the distinct tax treatment granted to commissioners and low-risks distributors can be justified on any grounds at all.[67]

The agency PE clause finds an exception in Article 5, paragraph 6, i.e., what is known as the independent agent clause. This agent enjoys a functional, legal, and economic independency in relation to the non-resident enterprise and performs his own business activities (on behalf of no one but himself). He manages resources autonomously and fully

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[61] This interpretation approach has been rightly criticized by A. Vázquez del Rey, *Poder tributario y establecimiento permanente. Análisis de la reciente jurisprudencia española*, 12(5) Revista Auctoritas Prudentium 5–12 (2015) and A. Ribes, *La difícil precisión de la noción de establecimiento permanente a través de la cláusula del agente dependiente (STS de 12 de enero de 2012, caso Roche)*, 4 Crónica Tributaria 30–33 (2012).

[62] Judgments of Audiencia Nacional 512/2010, 18 Feb. 2010, '*Madex*' case, 2662/2010, 9 Jun. 2010, '*Madex*' case and 2724/2016, 22 Jun. 2016, '*Cicl*' case, judgment of Tribunal Supremo 5475/2012, 12 Jul. 2012, '*Medefarma*' case and binding resolution of the General Directorate of Taxes v2420-12, 13 Dec. 2012.

[63] Hattingh noted that some jurisdictions (despite being fervent followers of the BEPS Project) surprisingly introduced reservations to the agency PE clause for tax competition reasons; *see* J. Hattingh, *The Impact of the BEPS MLI on International Tax Policies,* 72(4–5) Bull. Int'l Tax'n 239–240 (2018).

[64] OECD, *supra* n. 36, at 15–16 and Commentaries to Art. 5 of the 2017 OECD MC, para. 32.12. The reason is that a low-risk distributor is 'neither acting on behalf of that enterprise nor selling property that is owned by that enterprise'.

[65] M. F. De Wilde, *Lowering the Permanent Establishment Threshold via the Anti-BPES Convention: Much Ado About Anything?*, 45(8–9) Intertax 560 (2017).

[66] This conclusion was already reached by the Spanish tax administration in the binding resolution of the General Directorate of Taxes V2420-12, 13 Dec. 2012. The Directorate concludes that a low-risk distributor cannot qualify as a dependent agent insofar as it concludes contracts independently in its own name and on its own behalf. It acknowledges, however, that the distributor bears very limited inventory risks insofar as it only acquires the products from the Swiss entity once the final client (usually located in Spain or Andorra) has already formalized the purchase order.

[67] De Wilde, *supra* n. 65, at 560.

bears the entrepreneurial risks associated with activities, exposing himself to potential financial gains or losses.[68] Lack of control by the principal and risk assumption are thus the two key factors to effectively distinguish dependent from independent agents. There is, however, another factor that did not used to be decisive but needed to be assessed: the number of principals represented by the agent. When the agent worked for a number of unrelated principals, independency was more likely. When its activities were devoted exclusively or almost exclusively to one enterprise for a long period of time and its revenues mostly derived from such an enterprise, independency needed to be questioned and carefully assessed considering the control and risks factors.[69]

While the exclusivity factor was not decisive for either the old Article 5.6 nor the old Commentaries to the OECD MC, the BEPS Project introduced a non-rebuttable presumption according to which any agent acting exclusively or almost exclusively for one or more enterprises to which it is closely related[70] will not be considered independent for the purposes of Article 5.6.

5.6. ***Paragraph 5 shall not apply where the person acting in a Contracting state on behalf of an enterprise of the other Contracting state carries on business in the first-mentioned state as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.***

3 The Arrival of the New PE in the Global Tax Treaty Network and Potential Effects (Special Emphasis on the Spanish Case)

Throughout this section, answers to the following questions will be sought. First, will the new PE concept that emerged from BEPS be incorporated in a significant number of tax treaties (section 3.1)? Second, is the update of these tax treaties expected to put an end to unorthodox domestic interpretation approaches following ideas envisaged in the previous versions of the Commentaries to the OECD MC (e.g., 'Spanish PE approach') (section 3.2)? Third, is the amendment of domestic tax legislation necessary to accompany the new treaty rules? (section 3.3). Fourth, will the application of current profit attribution rules to the new PEs that emerged from BEPS expectedly result in an increase of the taxable base for the market jurisdictions? (section 3.4). When responding to these questions, Spain will again be used as an illustrative example:

3.1 *A Not so Warm Welcome (in Quantitative Terms)*

None of the proposals put forward by Action 7 reached the status of 'minimum standard' (compulsory adoption), however, they have been relatively positively welcomed by the international community.[71] Of the current 100 signatory jurisdictions of the MLI, 30% of them have adhered to the anti-fragmentation proviso to construction PEs (Article 5.3); 61% of them to one of the new approaches (either Option A or B) on the PE exemption of activities of preparatory or auxiliary nature (modified Article 5.4 in fine 2017 OECD MC); 59% of them to the antifragmentation clause for the purposes of applying the exemptions mentioned previously (new clause in Article 5.4.1 of the 2017 OECD MC)[72]; 52% of them to the new definition of the DAPE (modified Article 5.5 of the 2017 OECD MC); and 62% of them to the amendment of the independent agent concept (modified Article 5.6 2017 OECD MC). It is difficult to anticipate the actual number of tax treaties that will ultimately be affected by the modifications conceived by the BEPS Project for the PE concept, but the example of Spain will serve to demonstrate that, irrespective of the full commitment of a jurisdiction towards the new BEPS PE clause, the actual number of treaties affected within its treaty network may not be as high as expected.

It is no secret that the new PE that emerged from BEPS has long been awaited by Spain. This is apparent when reading the most representative resolutions and judgments of what is referred to as the 'Spanish PE approach' that have been pronounced over the last fifteen years[73] together with the national position for which Spain has adhered to the MLI, expressing full commitment to the articles aimed at amending Article 5 of the covered tax treaties. Spain only

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[68] Arnold, *supra* n. 47, s. 3.5.

[69] Commentaries to Art. 5 of the 2017 OECD MC, para. 32.6.

[70] *See* definition *supra* in footnote n. 23.

[71] https://www.oecd.org/tax/treaties/mli-database-matrix-options-and-reservations.htm (accessed 18 Mar. 2023).

[72] Thirty six percent of the signatory jurisdictions have reserved their right not to apply Art. 13 of the MLI to their covered treaties (Art. 13.6.a) while 5% of them have reserved their right not to apply Art. 13.4 of the MLI (via Art. 13.6.c), meaning that the remaining 59% of them have no objection to applying Art. 13.4 of the MLI (new Art. 5.4.1 of the 2017 OECD MC).

[73] *See* s. 2. Indeed, Action 7 is commonly regarded as a 'success' of the Spanish tax administration insofar as its rulings have been anticipating for years what the BEPS Project ultimately approved. Vid. Mas, *supra* n. 40, at 206.

made a reservation to the antifragmentation clause related to the construction PE for the sole reason that fragmentation is conveniently targeted by the principal purposes test to which Spain has adhered.[74] The question remains as to whether this undoubtedly strong national impulse may be translated into the evolution of actual treaty rules.

As noted earlier,[75] the effective modification of a tax treaty pursuant to the entry into force of the MLI is made dependent upon the fulfilment of the following four conditions simultaneously: (1) both contracting jurisdictions must sign and ratify the MLI, (2) both contracting jurisdictions must include the treaty in common among those covered, (3) both contracting jurisdictions must refrain from making a reservation on the relevant article (if applicable), and (4) both contracting jurisdictions must choose an equal (or at least compatible) normative option among those allowed by the MLI ('matching position'). Bearing this in mind, the authors will subsequently attempt to predict the actual number of Spanish treaties that will be affected by the new PE clause as a result of the MLI coming into effect in 2023.

The Spanish tax treaty network encompasses ninety-nine tax treaties in force at the present time.[76] Spain has listed most of its tax treaties among the 'covered' treaties for the purposes of the MLI: eighty-eight out of ninety-nine. The reason behind the exclusion of many of them is the fact that they were being (some still are) individually renegotiated at the time that the MLI was being signed and ratified.[77] Out of the eighty-eight explicitly covered treaties listed by Spain, twenty should be excluded in respect of which the relevant treaty partner has not signed the MLI[78] and an additional 1 as the treaty partner has signed the MLI but nevertheless left the Spanish treaty out of its scope.[79] This leaves sixty-seven treaties in force that may potentially be subject to changes pursuant to the MLI. Despite the fact that Spain has expressed its full commitment to implement these modifications in its tax treaty network, only covered treaties for which the treaty partner[80] holds a position that matches the Spanish one will ultimately be affected:

Modification	Modified treaties	Unaltered treaties
Anti-fragmentation proviso designed for the construction PEs (modified Article 5.3)	0 treaties (0%) *Reservation made by Spain[81]	99 treaties (100%)
'Preparatory and auxiliary nature' requirement to all listed/unlisted activities (Article 5.4 *in fine*)	32 treaties as a result of MLI [82] + 2 extra treaties renegotiated outside the MLI[83] = 34 (34.3%)	65 treaties (34 of which due to the lack of matching position) (65.7%)
Anti-fragmentation clause for the purposes of applying the PE exemptions mentioned previously (new Article 5.4.1)	37 treaties as result of MLI[84] + 2 extra treaties renegotiated outside the MLI[85] = 39 (39.4%)	60 treaties (29 of which due to the lack of matching position) (60.6%)
New definition of dependent agent (modified Article 5.5)	30 treaties as a result of MLI[86] + 2 extra treaties renegotiated outside the MLI[87] = 32 (32.3%)	67 treaties (34 of which due to the lack of matching position) (67.7%)

Notes

74 Art. 7 of the MLI (or new Art. 29 of the 2017 OECD MC). National position explained in s. 2.1.

75 Section 1.

76 https://www.hacienda.gob.es/es-ES/Normativa%20y%20doctrina/Normativa/CDI/Paginas/cdi.aspx (accessed 18 Mar. 2023). Treaties with Bahrein, Montenegro, Namibia, Peru, Syria, and Ukraine are currently being negotiated.

77 The most notorious examples are China, Denmark (denounced), Japan (renegotiated versions already in force), the Netherlands (pending renegotiation), Norway, Sweden, Timor Oriental, and Turkmenistan.

78 Argelia, Azerbaijan, Belarus, Bolivia, Brazil, Cabo Verde, Cuba, Dominic Republic, Ecuador, El Salvador, Iran, Kirgizstan, Moldavia, Philippines, Tajikistan, Trinidad and Tobago, Turkmenistan, the United States, Uzbekistan, and Venezuela.

79 Switzerland.

80 Here, the different options and reservations made by all signatory jurisdictions can be consulted https://www.oecd.org/tax/treaties/mli-database-matrix-options-and-reservations.htm, (accessed 18 Mar. 2023) and a dynamic database that allows us to select individual treaties and the 'matching positions' of the treaty partners that would result in their modification https://www.oecd.org/tax/treaties/mli-matching-database.htm, (accessed 18 Mar. 2023).

81 Amendment analysed in s. 2.1 where the reasons that led Spain (along with 70% of the signatory jurisdictions) to make a reservation to it are explained.

82 Argentina, Australia, Austria, Colombia, Costa Rica, Croatia, Egypt, Germany, India, Indonesia, Israel, Italy, Jamaica, Kazakhstan, Kuwait, Macedonia, Malaysia, Mexico, New Zealand, Nigeria, Pakistan, Russia, Saudi Arabia, Senegal, Serbia, Slovak Republic, Slovenia, South Africa, Tunisia, Turkey, Uruguay, and Vietnam.

83 The already renegotiated treaties with China and Japan include all of the BEPS innovations introduced to the new PE concept. *See* the renegotiated treaties with Japan https://www.boe.es/diario_boe/txt.php?id=BOE-A-2021-2977, (accessed 18 Mar. 2023) and China https://www.boe.es/diario_boe/txt.php?id=BOE-A-2021-4911, (accessed 18 Mar. 2023).

84 Argentina, Australia, Belgium, Chile, Colombia, Costa Rica, Croatia, Egypt, France, India, Indonesia, Ireland, Israel, Italy, Jamaica, Kazakhstan, Kuwait, Lithuania, Macedonia, Malaysia, Mexico, New Zealand, Nigeria, Pakistan, Portugal, Russia, Saudi Arabia, Senegal, Serbia, Slovak Republic, Slovenia, South Africa, Tunisia, Turkey, the United Kingdom, Uruguay, and Vietnam.

85 *See supra* footnote n. 83.

86 Albania, Argentina, Armenia, Belgium, Bosnia, Chile, Colombia, Costa Rica, Croatia, France, Israel, Jamaica, Kazakhstan, Lithuania, Macedonia, Mexico, New Zealand, Nigeria, Pakistan, Russia, Saudi Arabia, Senegal, Serbia, Slovak Republic, Slovenia, Thailand, Tunisia, Turkey, Uruguay, and Vietnam.

87 *See supra* footnote n. 83.

It should be noted that some of the treaties pending negotiation or renegotiation are expected to join the list of treaties with a renovated BEPS version of the PE concept if the national position expressed by the treaty partner in the framework of the MLI is to be trusted. It is to be expected that treaties with Namibia, Peru, and Ukraine will incorporate modifications to Articles 5.4, 5.4.1, and 5.5 while the treaty with the Netherlands will incorporate new Articles 5.4 and 5.4.1. The same cannot be expected from the treaty with Bahrein (that made reservations to all of these articles of the MLI) and those with Montenegro and Syria (that did not even sign the MLI).

It may be concluded that the strong ambition and impulse expressed by Spain concerning the modification of the treaty PE concept has not been massively shared by its treaty partners. The result is that approximately 60% and 70% of the treaties of the Spanish tax treaty network will maintain the classic PE concept:

3.2 *The End of Extensive Interpretation Approaches (Spanish PE Approach)?*

As was just concluded, the fact that the international community has generally welcomed the proposed amendments to the PE clause does not guarantee that a significant volume of actual treaties will ultimately be impacted. This brings up the question as to whether extensive interpretation approaches following the ideas envisaged in the Commentaries to the OECD MC will survive in relation to Article 5 of the treaties that will remain unaffected by the MLI (most probably the vast majority). To answer this question, the example of Spain and its paradigmatic 'Spanish PE approach' will again be used as reference since the conclusions that will be reached may be easily extrapolated to other jurisdictions holding equivalent interpretation approaches.

The coming into effect of Articles 12 to 15 of the MLI in Spain in 2023 will modify the way Article 5 will apply for approximately 30 and 40% of the treaties comprising the Spanish tax treaty network from that point on. This would theoretically eliminate the need to resort to the unorthodox extensive interpretations of the article promoted by the Commentaries to the OECD MC and followed by Spain (Spanish PE approach)[88] as a way to address its vulnerabilities. The question remains of how the Spanish tax administration and courts will continue to deal with the majority of the treaties (60–70% of the overall treaty network) that will continue to use the classic version of Article 5.[89] Will the 'Spanish PE approach' survive the implementation of the MLI in respect of this group of treaties? Will it cease to be valid?

It is this author's understanding that administration and courts should apply the PE concept that corresponds in each case. When they face the renovated version of Article 5, they should abide by it. When they face the classic version of Article 5, they should adhere to its wording no matter its deficiencies and vulnerabilities nor the tax risks that it creates. Unfortunately, there are no reasons to believe that the Spanish tax administration and courts (and probably other foreign ones) will abandon these well-established interpretation tendencies to protect their tax collection from tax strategies related to old versions of Article 5, such as the fragmentation of auxiliary activities or the conversion of agents into commissionaires. The authors cannot be optimistic because the soft law collection that once inspired and encouraged Spain and other jurisdictions to follow these interpretative approaches (with the Commentaries to the OECD MC being the most paradigmatic example) has experienced a significant increase as a result of the BEPS Project. Indeed, BEPS discussion drafts and reports on Action 7, the new 2017 OECD MC along with its new Commentaries and, ultimately, the MLI may have the effect of keep fuelling all these positions henceforth.

The authors opine that the Spanish PE approach, just as any other extensive interpretation tendencies of Article 5 followed by other jurisdictions pursuant to the Commentaries to the OECD MC, has always constituted an error for the following two reasons.

The first is because it generally involves granting a privileged interpretative value to the OECD soft law instruments that uphold these positions. It is clear, however, that the Model Convention, its Commentaries, nor any OECD reports (e.g., Transfer Pricing Guidelines or the Attribution of Profits to Pes Report) are (binding) legal norms or should have a privileged interpretative value over other sources of interpretation pursuant to Articles 31 to 33 of the Vienna Convention on the Law of Treaties. The only exception is whenever both contracting states agree to grant a specific value to any of these documents by including a clause in their treaty explicitly indicating this. Treaties that Spain shares with Albania, Bosnia, Croatia, Costa Rica, and El Salvador do include clauses in their respective protocols according to which the Commentaries to the OECD MC should have a prevalent value when the time comes to interpret the relevant treaty in general[90]; while treaties with Germany, Mexico,

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[88] Interpretation tendencies that were analysed in depth in s. 2.

[89] As explained before, the reasons behind this are manifold: Exclusion of the treaty from the list of those covered by Spain itself, no signature of the MLI by the treaty partner, exclusion of the Spanish treaty from those covered by the treaty partner, reservation made by the treaty partner for articles dealing with the PE concept, or lack of a matching position.

[90] The clause reads as follows: 'It is understood that provisions of the Agreement which are drafted according to the corresponding provisions of the OECD Model Convention on income and on capital shall be interpreted according to the OECD Commentaries thereon. The Commentaries – as they may be revised from time to time – constitute a

Norway, and the United States do likewise but only in respect of the interpretation of certain articles of the treaties. In the absence of an agreed clause of the kind, the OECD soft law collection of documents should not be granted an intrinsic privileged interpretative value and may only be favoured over other interpretation materials on the grounds of the authority, strength, and quality of its arguments.[91] This position, however, is far from being shared by the Spanish institutions. As for the tax administration, there are endless examples of administrative rulings and resolutions of the General Directorate of Taxes that systematically refer to the Commentary to the relevant article of the OECD MC to blindly and uncritically follow the criteria expressed by it to reach a conclusion.[92] As for the courts, they all depart from the self-evident premise that the Commentaries lack a legal and binding status[93] but do not hold a consistent position regarding the ultimate interpretative value they may be granted.[94] Some judgments have effectively conferred a de facto (pseudo-binding) privileged interpretative value to them (sometimes resulting in a treaty override),[95] while more recent ones have expressed a much more restrained position that is more respectful with the rule of law.[96]

The second is because the overuse of the Commentaries to the OECD MC as an interpretative tool becomes particularly severe when it leads to the infringement of the treaty itself (treaty override). As was cautioned in the previous section, Commentaries to the OECD MC have led Spain and other jurisdictions to pretend that the PE clause states something quite different than what it actually does. For example, the old Article 5.4 automatically excludes listed activities from the scope of the PE clause taking for granted their preparatory and auxiliary character, it simply does not subject its exclusion to the condition that they are considered as such in relation to the core business of the enterprise as the Commentaries suggest.[97] Similarly, the old Article 5.4 only allows the assessment of the preparatory and/or auxiliary character of the activities carried out in each separate fixed place of business individually, it does not, however, allow an overall assessment of all of the activities carried out in a territory, in distinct fixed places of business, and not only by the enterprise but also by its closely related entities as the Commentaries incite us to think.[98] Likewise, the old Article 5.5 explicitly requires the conclusion of contracts by the dependent agent and not the mere participation in its negotiation as the Commentaries propose.[99] In addition, this article expressly requires those contracts to be signed in the name of the principal, thus formally excluding the cases where the contract is signed in the name of the commissionaire (albeit on behalf of the principal) contrary to the Commentaries` own understanding.[100] These interpretation approaches held by the Commentaries have led Spain and other jurisdictions to counteract the weaknesses and insufficiencies of the wording of Article 5 by questionable extensive interpretations that far exceed its literalness and the possible meaning of its terms when not simply contradicting it blatantly.[101] These interpretations have been compromising the rule of law and the principle of legal certainty in Spain for the last fifteen years.

All of the reasons noted above invite the authors to think that the Spanish PE approach and equivalent interpretation tendencies have ultimately constituted an unfortunate mistake. However, continuing to uphold these approaches in 2023 while the MLI is already producing effects and in relation to treaties that maintain the classic version of the PE concept would constitute, *a fortiori,* an even more serious error.[102] This is because jurisdictions all around the world have been afforded the opportunity to easily modify the PE clause in their

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means of interpretation in the sense of the Vienna Convention of 23 May 1969 on the Law of Treaties'. Certain treaties include explicit reference to a specific version of the Commentaries in order to prevent dynamic interpretations.

[91] A. Navarro, *International Tax Soft Law Instruments: The Futility of the Static v. Dynamic Interpretation Debate*, 48(10) Intertax 848 (2020).

[92] In fact, most of the binding resolutions of the General Directorate of Taxes that have been referred to in this article do so.

[93] Judgment of Tribunal Supremo 887/2003, 12 Feb. 2003.

[94] For an exhaustive analysis of the use of the OECD soft law instruments by the Spanish Supreme Court, *see* F. Serrano, *La interpretación de los convenios de doble imposición internacional en la jurisprudencia del Tribunal Supremo Español: la función de los comentarios del modelo de convenio de la OCDE para evitar la doble imposición internacional en materia de renta* 341–342 Revista de Contabilidad y tributación 127 (2011) and the more recent work by M. González, *La interpretación de los convenios para evitar la doble imposición a la luz de la reciente jurisprudencia del Tribunal Supremo*, in *Cuestiones actuales y conflictivas de la fiscalidad internacional* (Merino Jara, I. (dir.), Wolters Kluwer España 2022).

[95] Judgments of Tribunal Supremo 6349/2000, 29 Jul. 2000 (allowing a dynamic interpretation of treaties insofar as Spain has not made any 'reservation' to the relevant Commentary); 5265/2008, 11 Jun. 2008 (concluding that the relevant rule 'had to be' interpreted in light of the OECD MC Commentaries and allowing a dynamic interpretation of Art. 17 of the treaty dealing with artists and sportspersons that resulted in the application of the special anti-avoidance proviso envisaged in OECD MC in Art. 17.2 in the context of an old 1971 treaty that lacked such a clause) and 3172/2012, 28 Mar. 2012.

[96] Judgments of Tribunal Supremo 1071/2020, 3 Mar. 2020, '*Stryker*' case (it makes it clear that the Commentaries are soft law instruments with only 'informative' value and effectively limit the scenarios in which dynamic interpretations of treaties may be allowed to avoid situations of treaty override) and 3063/2020, 23 Sep. 2020, '*Colgate Palmolive*' case (it limits the dynamic interpretation of treaties in a case where the appealed judgment had inappropriately used the beneficial owner clause in a case related to royalties when applying a treaty that lacked such a clause in Art. 12 on the grounds of its existence in Art. 12 of the OECD MC).

[97] Section 2.2.

[98] *Ibid.*

[99] Section 2.3.

[100] *Ibid.*

[101] A view shared by Martín Jiménez, *supra* n. 18, at 467–468.

[102] M. González & L. E. Guerrero, *Reflexiones sobre la noción de Establecimiento Permanente en las estructuras operativas de filiales comisionistas: el 'Spanish approach' en fiscalidad directa y su difícil encaje en ámbito del IVA*, 18 Revista de fiscalidad internacional y negocios transnacionales (2021), s. 2.

respective treaty networks in the event of dissatisfaction with it by simply adhering to the MLI. If a jurisdiction declines this invitation for whatever reason, its intention to stick to the old version of Article 5 appears to be evident. Would Spain or other jurisdictions be entitled to interpret the PE clause envisaged in the treaty they share with such jurisdiction in a BEPS-style way? Clearly not:

3.3 *Relationship Between Treaty and Domestic PE Rules and the (Most Likely) Need to Amend the Latter*

PE provisos envisaged in many tax treaties (e.g., 30–40% of the Spanish network) will experience significant alterations in their application as the MLI comes into force in the territories of both contracting jurisdictions. This will result in the *potential* broadening of taxing rights of the source state in respect of the business profits made by non-resident enterprises in their territories as the volume of PEs is expected to increase significantly as a result of the new BEPS clause. The authors deliberately use the word *potential* because tax treaties do not create new taxing rights but simply limit the way states can exercise their taxing rights pursuant to their domestic tax legislation on the basis of the requirements and conditions imposed by the treaty with the objective of either preventing or correcting double taxation.[103] This ultimately means that treaties modified by the MLI will allow source jurisdictions to tax the business profits of non-resident enterprises in more scenarios, but actual tax liabilities will only arise insofar as they are conveniently envisaged in the domestic tax legislation of the relevant jurisdiction. This should make all jurisdictions that have adhered to the new BEPS PE clause in the framework of BEPS meditate on whether their domestic legislation effectively allows them to tax in all the situations now allowed by the new clause, which is expected to produce effects in a number of their tax treaties.

Is the Spanish domestic PE concept well equipped to ensure the exercise of taxing rights by Spain in the situations now allowed by the new BEPS clause? The response is negative.

The Spanish PE proviso[104] is based on the classic version of OECD MC Article 5, albeit with a much broader scope for a number of reasons. First, the place of business does not need to be 'fixed'. Second, the list of examples of places of business is not only longer[105] but also has constitutive character which means they will automatically be considered as PEs irrespective of other considerations.[106] Third, no activities (e.g., of preparatory and/or auxiliary character) are excluded from the scope of the clause. Fourth, the time threshold for the construction PE is set at 6 months following the example of the UN MC. Fifth, agents of independent status (e.g., brokers, general commission agents) are not excluded from the scope of the agency PE clause.[107]

In light of the above, which modifications to the Spanish PE clause are necessary and which others are not? On one hand, it is urgent to update the DAPE clause to ensure its consistency with the new Article 5.5. A lack of amendments will legally prevent Spain from taxing the business profits attributable to local dependent agents that simply participate in the negotiation of the contracts (without formally concluding them) or commissionaires that conclude contracts in their own name but on behalf of the principal (indirect intermediations) within the Spanish territory. On the other hand, the fact that the Spanish proviso does not exclude auxiliary and/or preparatory activities or independent agents from the scope of the clause, makes it unnecessary to implement further changes in this regard, as Spain will be, in any case, entitled to tax the profits attributable to new PEs resulting from the changes to Articles 5.4 and 5.6 of the treaty:

3.4 *Attribution of Profits: The Forgotten Rule That May Render the New PE Useless*

The gradual implementation of the new BEPS PE concept will expectedly result in a significant rise of PEs in the market jurisdictions. A different question (and definitely much more important) is whether such an increase will be translated into an increase of taxable bases in such jurisdictions. The answer requires analysing whether current rules to attribute profits to PEs will ultimately grant more profits to the PE jurisdictions as a result of the amendments introduced to the PE concept.

The rule guiding the attribution of profits to PEs is envisaged in OECD MC Article 7.2 which was amended (for the sake of greater precision) by the 2010 OECD MC version after the extensive work of the OECD on the matter (labelled as 'authorized OECD approach', hereinafter AOA)[108]:

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[103] K. Van Raad, *Five Fundamental Rules in Applying Tax Treaties*, in *Liber Amicorum Luc Hinnekens* 587–590 (J. F. Avery Jones, Bruylant 2002).

[104] Article 13.1.a) of the Non-Residents Income Tax.

[105] It replicates OECD MC Art. 5.2 but adds warehouses, stores, or other establishments.

[106] On the other hand, the examples of places of business provided by OECD MC Art. 5.2 needed to comply with the general requirements of Art. 5.1 in order to qualify as PEs (Commentaries to Art. 5 of the 2017 OECD MC, para. 45).

[107] The Supreme Court concluded that an entity resident in Liechtenstein (no tax treaty with Spain) had a PE in Spain because it was acting in Spanish territory through an agent that concluded contracts in the name and on behalf of the former irrespective of the fact that it was legally and economically independent of the entity. *See* judgment of Tribunal Supremo 7418/2008, 29 Oct. 2008.

[108] OECD, *Report on the Attribution of Profits to Permanent Establishments* (2008) and OECD, *Report on the Attribution of Profits to Permanent Establishments* (2010).

> 7.2. (…) The profits it might be expected to make, ***in particular in its dealings with other parts of the enterprise,*** if it were a separate ***and independent*** enterprise engaged in the same or similar activities under the same or similar conditions ***taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.***

The objective of this provision is to treat the PEPE for tax purposes *as if it were* a fully functional separate person independent from the rest of the enterprise and engaged in the same or similar activities. The clause is thus construed on two distinct fictions, i.e., the distinct legal personality between the PE and 'the rest of the enterprise' and its independency to it.

First of all, it is evident that the PE is not a '*separate*' enterprise as it is not legally distinct from the rest of the enterprise. Indeed, the PE lacks legal personality and is therefore unable to legally own assets, assume risks, possess capital, or conclude contracts. This fact makes it necessary to develop a first fiction upon which it can be hypothesized that the PE is a (functionally) separate enterprise distinct from the legal entity to which it actually belongs. To this end, there is a need to '*put flesh onto the fiction*' by equipping the PE with the assets, risks, and capital it would have if it truly was a separate entity performing the same functions.[109] This exercise departs from the identification of the significant people functions effectively performed by the PE (as opposed to those performed by the other parts of the enterprise) so that the PE could be attributed the economic ownership of the assets and capital presumably used in the functions it performs[110] and the risks inherent in (or created by) the performance of such functions.[111]

Once the PE is hypothesized to economically own the necessary assets, capital, and risks associated with the performance of such functions, the second fiction requires assuming that this hypothesized distinct enterprise is a person independent of anyone else (including the rest of the enterprise to which it belongs). This is done in order to determine the profits it would have obtained. To do so, the arm´s length standard needs to be applied to both its transactions with associated enterprises and its dealings with the rest of the enterprise (i.e., the head office)[112] in order to secure a tax treatment analogous to that between truly independent parties.[113] For these purposes, the OECD suggests the application, by analogy, of Article 9 of the OECD MC and the Transfer Pricing Guidelines when attributing profits to the PE pursuant to OECD MC Article 7.2.[114]

When the time came to revisit this clause after the proposed amendments to the PE concept, the OECD concluded that the new PE concept did 'not require substantive modifications to the existing rules and guidance concerning the attribution of profits to a permanent establishment under Article 7'.[115] Stated differently, changes to Article 7 of the OECD MC and its Commentaries were not considered convenient at that time. The OECD, however, mandated further work on anticipating how it would apply to the new set of PEs, in particular those outside the financial sector.[116] The mandate was later accomplished in its 2018 report that provided guidance on the expected profits that would be attributable to new PEs arising from the changes proposed to OECD MC Article 5.4 and 5.5[117] along with specific examples illustrating the application of Article 7 to them.[118]

To the question of whether the application of current profit attribution rules to the new PEs emerged from BEPS will expectedly result in an increase of taxable bases for the market jurisdictions, the response is probably not. It must be borne in mind the sort of enterprises that are more likely to witness the arising of new PEs in their market jurisdictions, and those are principals (as a result of the new agency PE clause) and remote sellers (as a result of changes to Article 5.4). What can be expected from the

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[109] W. Schön, *International Tax Coordination for a Second-Best Word (Part I)*, 1(1) World Tax J. 67, 104 (2009): '(the AOA) *transforms the PE into a notional subsidiary for the purpose of tax allocation*'.

[110] OECD, *supra* n. 108, at 15–16.

[111] OECD, *supra* n. 108, at 16–17.

[112] As for the internal dealings between a PE and its head office, the PE should be remunerated for tax purposes at arm´s length which is a price equal to the amount that the enterprise would have incurred if it had outsourced the functions now performed by the PE to independent parties.

[113] Dealings between the PE and the head office are generally recognized and thus treated as transactions between related parties just as if they were separate and associated enterprises. *See* OECD, *supra* n. 108, at 18–19 and Schön, *supra* n. 108, at 111: 'the OECD´s profit attribution project hypothesizes the permanent establishment as an independent unit capable of entering into notional dealings with the head office, as are regularly concluded between a parent and its subsidiary company'.

[114] Commentary to Art. 7 of the 2017 OECD MC, paras 16 and 20 and OECD, *supra* n. 108, at 20.

[115] OECD, *supra* n. 36, at 45.

[116] *Ibid.*

[117] Changes addressed in ss 2.2 and 2.3 respectively.

[118] OECD, *Additional Guidance on the Attribution of Profits to Permanent Establishments*, BEPS Action 7 (2018). Tracana analyses the effects of the OECD guidance on profit attribution to new agency PEs, concluding that both the guidance and the four examples provided by the 2016 discussion draft are not consistent with the wording, purposes, and effects of OECD MC Art. 7 of the. *See* D. Tracana, *The Effect of the OECD/G20 BEPS Initiative on the Attribution of Profits to Permanent Establishments: The Special Case of Agency PEs*, 71(3–4) Bull. Int'l Tax'n (2017).

application of the first step of the AOA methodology to principals and remote sellers? Will they presumably perform significant people functions within the PE territory? It seems clear that no significant people functions will normally be performed by the former while mere routine functions will typically be performed by the latter. As for the latter, the performance of such auxiliary and low value adding functions would not be sufficiently capable of attracting a relatively significant amount of the enterprise´s assets, risks and capital when the time comes to build the hypothesized separate entity. It follows that no or very little profit would thus be attributable to these new PEs under current profit attribution rules.[119]

This does not necessarily mean that the market jurisdiction would end up completely empty-handed. On one hand, commissioners acting in the market jurisdiction on behalf of the non-resident principal will be remunerated at arm´s length, and such payment would commonly be taxable therein as part of the worldwide income of the (supposedly) resident commissioner. The key issue here is that new rules would not result in the non-resident principal´s own profits being taxable in the market jurisdiction above the remuneration already mentioned.[120] On the other hand, operators of the warehousing facilities providing storage services to the non-resident enterprise should be equally remunerated at arm´s length under OECD MC Article 7.2. However, given that these services are inherently auxiliary and low value adding (irrespective of their relative relevance in relation to the core business of the enterprise), such remuneration is expected to be insignificant for the reasons explained above.[121]

The underlying reason for this outcome lies in a more general and fundamental tax policy decision upon which the current international tax system is built. Rules guiding the taxation of PEs (both the concept itself and profit attribution rules) were originally conceived on the premise that profits should be allocated to the supply side of income production.[122] This is where enterprises keep their labour and capital. As De Wilde properly cautions, the intention of the OECD to switch to a new PE concept that is closer to the market jurisdiction has not been consistently followed by a new set of profit attribution and transfer pricing rules that place the emphasis on the demand side. This being the case, the implementation of the new PE concept is not expected to generate much (extra) tax base for the market jurisdictions,[123] ultimately turning all of these treaty developments in a 'paper tiger'.[124]

Naturally, unorthodox interpretations of profit attribution rules deviating from the ordinary meaning given to the terms of Article 7, its light and purpose, may well result in the long-awaited shift of greater profits to jurisdictions hosting the new types of PEs.[125] Once again, Spain has regrettably led this tendency long before the formal arrival of the new PE concept.[126] One of the most shocking conclusions reached by the Spanish National and Supreme Courts in the *Roche* case was precisely that all profits derived from Spain were regarded as attributable to the local PE of the Swiss taxpayer and not solely the arm´s length remuneration for the mere manufacturing functions effectively performed by the local PE in Spain, thereby omitting the fact that many of the functions related to those sales were performed by the Swiss head office and not on Spanish soil.[127] A similar conclusion was reached by both courts a few years later in the *Dell* case.[128]

It is not necessary to state that the 'Spanish PE approach' is not the proper way to achieve the desired outcome of granting greater taxing rights to the market jurisdictions hosting the new types of PEs as it eradicates the rule of law and the principle of legal certainty. If jurisdictions feel that this must be achieved, it cannot be at all costs. Instead, profit attribution and transfer pricing rules should be amended to place the necessary emphasis on the demand side of income production by, for example, adopting a formulary apportionment model containing a sales factor. This was already proposed within the framework of the

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[119] De Wilde, *supra* n. 65, at 564–566: 'given the current international standards for profit attribution and transfer pricing, the MLI provisions on commissionaires and auxiliary activities would seem likely to have little impact in terms of effectively shifting tax base towards market jurisdictions'.

[120] This was anticipated by the judgment of the Dutch Supreme Court 258/1988, '*Cargadoorsarrest*' case: 'even if an agency permanent establishment existed, the profit attributable to it would be zero because of the remuneration paid to the agent being deductible in the hands of the permanent establishment'.

[121] De Wilde, *supra* n. 65, at 564.

[122] This may be logically inferred from the wording of these rules but was explicitly admitted by the OECD in OECD, *Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce? Final Report* (2003).

[123] De Wilde, *supra* n. 65, at 563.

[124] *Ibid.*, at 563–565.

[125] As De Wilde cautions, it can be expected that the implementation of the MLI may 'tempt countries to claim a larger share of the "tax pie" than they are eligible for under the rules currently applying for attributing profit internationally' (De Wilde, *supra* n. 65, at 566).

[126] When it comes to applying both treaty and domestic profit attribution rules, Spain tends to follow the same patterns of interpretation suggested by the OECD in its MCs and soft law documents (A. Navarro, *Consideraciones críticas sobre las normas de atribución de beneficios a establecimientos permanentes en el IRNR*, 184 Revista española de Derecho Financiero 142–144 (2019)). However, Spain has deviated from them in certain paradigmatic judgments (that will be analysed subsequently) and has thus claimed for wider taxing rights than those strictly allowed by profit attribution rules in place (Martín Jiménez, *supra* n. 18, at 468–469 and 470–472).

[127] Judgments of Audiencia Nacional 248/2008, 24 Jan. 2008 (legal argument 7) and Tribunal Supremo 201/2012, 12 Jan. 2012, 'Roche' case (legal argument 5). This position was severely criticized by Vázquez del Rey, *supra* n. 61, at 13 and 25–26, J. Zornoza & A. Báez, *La cláusula de EP frente al tratamiento de las reestructuraciones empresariales: los casos Roche y Dell*, in *Temas selectos de precios de transferencia* 119–154 (Y. Hashimoto, Themis 2015) and Navarro, *supra* n. 126, at 163. All of these authors share the position that the Spanish courts deviated from the correct and standardized application of both the treaty and the domestic rules guiding the attribution of profits to PEs.

[128] Judgments of Audiencia Nacional 2153/2015, 8 Jun. 2015 and Tribunal Supremo 2861/2016, 20 Jun. 2016, 'Dell' case.

European Commission's proposal for a directive for a Common Consolidated Corporate Tax Base (CCCTB)[129]

4 Concluding remarks

The amendment of the PE clause via the codification of many of the ideas expressed by prior versions of the Commentaries to the OECD MC and their effective upgrade to the level of the Model Convention itself (and, subsequently, actual tax treaties due to the magic of the MLI) should be, at least *conceptually*, applauded. This is because it involves the direct confrontation of the structural problems and inherent limitations long present in the wording of Article 5 via its direct amendment, It thus abandons the questionable interpretative path taken by Spain (Spanish PE approach) and other jurisdictions that struggled with those problems by going well beyond the literalness and the possible meaning of the terms of the clause (when not simply contradicting it blatantly) with the consequent damage to the rule of law and the principle of legal certainty. With that in mind, the alignment of the wording of the clause to the authors' own expectations appears to be the most honest path. Stated bluntly, if we dislike that the clause says A and strongly believe that it should really say B, then we should not keep pretending that the clause says B but rather amend it straightaway to make it say B.

That stated, all of the risks that this tax reform is expected to give rise to should not be ignored.

First of all, it can be expected that the actual number of tax treaties that will potentially see their respective PE clauses modified in the BEPS-style way will be rather limited. This is because many conditions must be fulfilled simultaneously before the MLI actually triggers the modified application of a particular tax treaty.[130] This is well illustrated by the example of Spain where the extraordinary institutional impulse for the amendment of the PE clause did not prevent approximately 60–70% of its tax treaties from retaining their old Article 5.[131] This being said, there should be continued vigilance in ensuring that tax administrations and courts worldwide do not seek to legitimize the continued use of unorthodox interpretation approaches (e.g., Spanish PE approach) with respect to this group of treaties by means of the new BEPS soft law toolkit.[132]

Secondly, the reform undoubtedly closes a number of loopholes long present in the classic PE clause (e.g., commissionaire arrangements, fragmentation of auxiliary and preparatory activities) but inadvertently opens up new ones. Low-risk distributors (those that acquire the products from the non-resident entity to immediately sell them in its own name and do so without assuming only minimal risks) would fall outside the scope of the PE clause, both in its old and its new wording, as they conclude contracts on their own behalf. As they are hardly distinguishable from commissionaires from an economic standpoint, a massive conversion of commissioners to low-risk distributors is to be expected as the MLI enters into force worldwide.[133]

Thirdly, jurisdictions (such as Spain) adhering to the new BEPS-like PE clause via the MLI need to reflect on the consistency between the new treaty clause and their respective domestic PE clauses. This is because the modified treaty may grant them new taxing rights in respect of business profits attributable to new forms of PEs, but jurisdictions can only legally exercise such taxing rights insofar as the tax liability is conveniently envisaged in their domestic tax legislation.[134] As for the case of Spain, the need to update its domestic DAPE clause is urgent, or else it will not be legally entitled to tax profits attributable to local dependent agents that simply participate in the negotiation of the contracts (without formally concluding them) or commissionaires that conclude contracts in their own name but on behalf of the principal (indirect intermediations) within the Spanish territory.

Lastly, a significant increase in the volume of PEs is to be expected as a result of the broadening of the PE concept, but this will most likely not result in an increase of taxable bases and revenues for the source jurisdictions. This is due to the inability of current profit attribution and transfer pricing rules to attribute profits (very scarce or simply none) to the new forms of PEs as they are expected to perform either limited low value adding or even no functions at all in the source jurisdiction.[135] It is needless to state that unorthodox interpretations of these rules like those followed by the Spanish courts in the *Roche* and *Dell* cases are not the proper way to drag greater taxable bases to the market jurisdictions. In the absence of the amendment of these rules to ensure a greater emphasis on the demand at the expense of the supply side, this tax reform would simply prompt a new set of profitless *phantom* PEs and, what is even worse, coupled with an ultimately unnecessary increased administrative burden and legal uncertainty.[136]

Notes

[129] De Wilde, *supra* n. 65, at 565–566.

[130] Sections 1 and 3.1.

[131] Section 3.1.

[132] Section 3.2.

[133] Section 2.3.

[134] Section 3.3.

[135] Section 3.4.

[136] Labels rightly granted by De Wilde, *supra* n. 65, at 563–565.