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PERSPECTIVE ON PERMANENT ESTABLISHMENT: APPRAISAL OF ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS UNDER THE ETHIOPIAN INCOME TAX SYSTEM

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Abstract

The allocation of taxing rights between states concerning business profits of Multinational Enterprises (MNEs) is a very complex activity. The central notion of the allocation rules is that the host state is competent to impose an income tax on the profits of non-resident enterprises if and only if the concerned enterprises have the Permanent Establishment (PE). However, owing to the gaps in the definition of PE as envisaged under bilateral double taxation agreements and national tax laws, the artificial avoidance of PE status has become an international agenda. In response to this, the OECD and G-20 countries have adopted 15 points action plans to address Base Erosion and Profit Shifting (BEPS) and Action Plan 7 has laid out a path to prevent the artificial avoidance of PE status. Coming to Ethiopia, the way the definition of PE is articulated has room for MNEs to artificially avoid PE status, which results in the loss of revenue for the government. The aim of this article is to examine the room for artificial avoidance of PE status under the Ethiopian income tax system and explores opportunities for further regulation. To this end, it employed doctrinal research methodology to investigate the pertinent provisions of the Income Tax law and double taxation agreements. Accordingly, the paper's finding shows that Ethiopian income tax law has not adequately tackled artificial avoidance of PE status through commissionaire arrangement and splitting up of the contract. Concerning double taxation agreements of Ethiopia, saving for artificial avoidance of PE status through the independent agent that incidentally tackled, no countermeasures has taken against artificial avoidance of PE status through specific activity exemption, splitting up of the contract, and dependent agency commissionaire arrangement. Hence, it is recommended for Ethiopia to integrate countermeasures for artificial avoidance of PE status into domestic law and double taxation agreements.

KEY WORDS: Permanent establishment, artificial avoidance, commissionaire arrangement, specific activity exemption, splitting up of contract

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I. INTRODUCTION

The concept of a permanent establishment is a fundamental idea that is intrinsic to double taxation agreements.[1] The existence of a Permanent establishment is a minimum threshold that must be cleared for a country to tax a non-resident's business profits derived from sources in that jurisdiction.[2] The concept of PE is one of the most crucial threshold in international taxation as it determines whether the source state can legitimately claim taxing rights concerning income generated within its territory.[3] The permanent establishment marks the dividing line for business between merely trading with a country and trading in that country.[4] If an enterprise has a permanent establishment, its presence in a country is sufficiently substantial that it is trading in the country.

Although the definitions of Permanent Establishment might vary across countries to take into account the enacting country's specific circumstances, most states draw on the general principle of the OECD and UN model convention, which defines Permanent establishment in Article 5 Paragraph (1) as "A fixed place of business through which the business of an enterprise is wholly or partly carried on."[5] Both OECD and UN model conventions have not clarified the elements of the definition of PE. However, the commentary on article 5 of the OECD model convention has provided what constitutes "fixed'', "place of business'' and "when the enterprise is said to be carried on wholly or partly at the fixed place.'' Accordingly, fixed refers to a link between the place of business and a specific geographic point and a degree of permanence with respect to the taxpayer.[6] A place of business refers to some facilities used by an enterprise for carrying out its business, i.e., a facility such as premises or, in certain instances, machinery or equipment.[7] The mere presence of the enterprise at that place does not necessarily mean that it is a place of business of the enterprise. The facilities need not be the exclusive location, and they need not be used exclusively by that enterprise or for that business. However, the facilities must be those of the taxpayer, not another unrelated person. Thus, regular use of a customer's premises does not generally constitute a place of business.[8] Business of the enterprise must be carried on wholly or partly at a fixed place, and this usually means that persons who, in one way or another,

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[1] Leonardo F.M. Castro, Problems Involving Permanent Establishments: Overview of Relevant Issues in Today's International Economy,*2(2) GLOBAL BUS. L. REV*,2012, at 129

[2] See Cormac Kelleher, Problems with Permanent Establishments, TTN conference, Prague, September 2009, p.1, available at https://www.ttn-taxation.net/pdfs/prizes/CormacKelleherEssay.pdf (Accessed on May 20, 2021).

[3] Atanasov Atanas, Permanent Establishment 2.0 - Is It Time for an update? 2017, at 14, Available at SSRN: http://dx.doi.org/10.2139/ssrn.3017892(Accessed on May 20, 2021)

[4] PHILIP BAKER, DOUBLE TAXATION CONVENTIONS: A MANUAL ON THE OECD MODEL TAX CONVENTION ON INCOME AND ON CAPITAL, (3rd edition, Thomson/Sweet & Maxwell, London,2009), at 2.

[5]. OECD model convention, 2017 update, Art. 5(1) (hereafter called OECD model convention) available at https://www.oecd.org/ctp/treaties/2017-update-model-tax-convention.pdf. (Accessed on June 05, 2021)

[6] Commentary on OECD model convention 2017 paragraph 5-6 to Article 5 available at https://www.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2017_mtc_cond-2017-en (Accessed on June 05, 2021)

[7] *Id*., at para. 2.

[8] *Id*., at para. 4.

are dependent on the enterprise (personnel) conduct the business of the enterprise in the State in which the fixed place is situated.[9]

In a nutshell, the main use of a permanent establishment is to determine the right of a Contracting State to tax the profits of an enterprise of the other Contracting State.[10] However, owing to the gaps or mismatches attributed to the definition of PE as envisaged under the UN and OECD Model Conventions and national laws, MNEs have resorted to tax base erosion and profit shifting. One of the prominent strategies used by MNEs to escape the payment of tax is the artificial avoidance of PE status. Accordingly, artificial avoidance of the status of PE through commissionaire arrangements, specific activity exemptions, and splitting up of contracts are the prominent strategies used by MNEs to erode the source country's tax base.[11]

In response to the overwhelming acts of MNEs in eroding tax bases, the G-20 countries and the OECD have tried their best to solve the problems underlying base erosion and profit shifting by multinational Enterprises. Accordingly, in September 2013, the OECD and G-20 countries adopted 15 points action plans to address BEPS, including artificial avoidance of PE status.[12]

Coming to Ethiopia, the Federal Income Tax Proclamation No 979/2016 (hereafter called Ethiopian Income Tax Proclamation) defines PE as "a fixed place of business through which the business of an enterprise is wholly or partly carried on.''[13] The Income Tax Regulation No. 410/2017(hereafter called Ethiopian Income Tax Regulation) has also provided some rules on PE.[14] Besides, with the primary objective of fighting double taxation and fiscal evasion, Ethiopia has signed more than 32 bilateral double taxation agreements with other world countries.[15] Some of these bilateral tax treaties have been ratified by both signing states, and even ratification documents have been exchanged. Some of them, once again, was ratified by the Ethiopian parliament, while others were signed but not yet ratified. There are only 11 double taxation treaties that become effective upon ratification by both governments and the exchange of ratification instruments.[16] One of the critical concerns of the bilateral double taxation agreement is PE. Saving for slight differences in the way they provide the list of activities that constitutes PE, all bilateral tax treaties of Ethiopia have defined permanent establishment in similar ways. As it has been discussed, owing to the gaps attributed to the definition of PE as envisaged under double taxation agreements and national tax laws, the artificial avoidance of PE status has

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[9] *Id*., at para. 7

[10] *Id.*

[11] OECD, PREVENTING THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS, ACTION 7 – 2015 FINAL REPORT,(hereafter called OECD/G20 Action 7 – Final Report 2015)available at https://www.oecd.org/ctp/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report-9789264241220-en.htm, (Accessed on July 28, 2021)

[12] *Id.*

[13] *Federal Income Tax Proclamation of Ethiopia*, Proclamation No.979/2016, FEDERAL NEGARIT GAZZETTA, year22 no.104, Addis Ababa, 2016, (hereafter called Income Tax Proclamation No.979/2016), Art.4(1)

[14] *Councils of Minister's Federal Income Tax Regulation,* Regulation No. 410/2017, FEDERAL NEGARIT GAZETA, 23rd Year, No.82, 2017 (hereafter called Income Tax Regulation No.410/2017), Art. 4.

[15] Serkalem Eniyewu, Involving Constituent States in Negotiating Tax Treaties in Ethiopia (Unpublished Master's thesis, Addis Ababa University,2017), at.35

[16] *Id.*

become an international agenda. Accordingly, the definition of PE as envisaged under domestic income tax laws and double taxation agreements signed by Ethiopia has room for MNEs to avoid PE status artificially.

Therefore, this article aims to examine the adequacy of the Ethiopian income tax system to prevent the artificial avoidance of the status of PE and to explore opportunities for further regulation. To this end, the article has investigated the pertinent provisions of the Ethiopian income tax proclamation, income tax regulation, and the double taxation agreements signed by Ethiopia.

This article is organized into five sections including the introductory part. The second section uncovers the common strategies for the artificial avoidance of PE status. The third section presents the global initiatives on preventing the artificial avoidance of PE status. The fourth section analyses the room for the artificial avoidance of PE status under the Ethiopian income tax system. The fifth section finalizes the article by way of a conclusion and recommendation.

II. COMMON STRATEGIES FOR ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS UNDER THE INTERNATIONAL TAX SYSTEM

It is complex to speak about 'artificial avoidance of PE status' since what may be avoidance for one country may not be the same for another that interprets the PE principle differently.[17] For instance, this has been observed in Dell cases in Norway and Spain. While a typical commissionaire structure withstood the exam of the Norwegian Supreme Court, which ruled that there was no PE, the same agreement was regarded as a PE in Spain.[18] Although the term 'artificial' was given no specific definition in the Final Report on Action Plan 7, the report has elaborated on different ways of avoiding PE status.[19] Attempts to understand the current problems of PE and define artificial avoidance of PE status would, therefore, call for a reference to the historical evolution of the concept of PE.[20] The term artificial avoidance is first heard during the famous ruling of the European Court of Justice in the Cadbury Schweppes case.[21]Although this case primarily dealt with the application of controlled foreign corporation legislation, the Court defined an artificial arrangement as a fictitious establishment not carrying out any genuine economic activity.[22]

[17] Adolfo Martín Jiménez, Preventing the Artificial Avoidance of PE Status, a preliminary document circulated at the United Nations Workshop on "Tax Base Protection for Developing Countries" (Paris, France, September 23, 2014), at13.

[18] *Id.*

[19] Gustav Einar, Dependent Agents After BEPS Especially Concerning Commissionaire Arrangements, (Master's Thesis,2017, Uppsala University), at 22

[20]Jiménez, *supra* note 17, at13.

[21] Arthur Pleijsier, the Artificial Avoidance of Permanent Establishment Status: A Reaction to the BEPS Action 7 Final Report, INTERNATIONAL TRANSFER PRICING JOURNAL**,**442**,** 2016, at 443

[22] *Id.*

The concept of PE is subject to criticism by academicians worldwide for being obsolete and problematic which is attributed to an ambiguous and flexible PE definition.[23] Previously, the fundamental concern behind PE was the removal of obstacles causing double taxation due to the negative impact on international trade; however, the concern of preventing BEPS through practices that lead to artificial avoidance of PE status by non-resident enterprises is currently added.[24] Jiménez argues that it may be inherently difficult to establish avoidance of PE status since the PE concept constitutes an exemption to the general rule known as resident taxation.[25] The result of the avoidance of PE status is the absence of liability to pay tax in the source country which would comply with the main rule of resident taxation.[26] Jiménez points out that it is hard to accomplish the goal of BEPS to align taxation to the source countries when the PE concept itself is designed to "avoid as much source taxation as possible."[27] He argues that the PE concept affects practice as it segregates taxable income from where the economic activity was generated.[28] Moreover, as Eisenbeiss observes, the underlying problem is not only the increasing artificial avoidance of PE status but also, the PE concept itself that gives rise to the dislocation of the taxation of modern economic activity.[29] Various MNEs have been and are still using the loopholes concerning the definition of PE to artificially avoid the status. The common strategies for artificial avoidance of PE status are presented as follows:

A. Artificial Avoidance of PE Status through Commissionaire Arrangements

Commissionaire structures have been used for tax planning purposes since the1990s.[30] A commissionaire agreement can be described as an arrangement where a person in one state sells a product in its name, but on behalf of an enterprise in another state, which is the actual owner of the products.[31] MNEs often use the arrangement in business restructuring to maximize profits.[32] The OECD describes commissionaire arrangements as a structure used preliminary to avoid taxation by, for example, eroding taxation in the state where the sales take place.

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[23] Tan Ching Khee & Henry Syrett, 'Impact of OECD BEPS Action 7 Proposals on Modification of Articles 5(4), 5(5) and 5(6) of OECD Model Convention - An Evaluation of Action 7 on the Future of Intra-Group Transactions and Business Models of MNEs in their Cross-Border Investments,5(2) SINGAPORE MANAGEMENT UNIVERSITY SCHOOL OF ACCOUNTANCY RESEARCH, 2017, at 5

[24] *Id*.

[25] Jiménez, supra note 17, at 9

[26] *Id*.

[27] *Id*.

[28] *Id*.

[29] Justus Eisenbeiss, BEPS Action 7: Evaluation of the Agency Permanent Establishment,44(7) INTERTAX,481, 2016, at.494

[30] Hiroshi Oyama, Countering BEPS: Preventing Abusive Commissionaire Arrangements, INTERNATIONAL TAX NOTES, 2014, at1164.

[31] OECD/G20 Action 7 Final Report, 2015, Para5

[32] Madalina Cotrut, International Tax Structures in the BEPS Era: An Analysis of Anti-Abuse Measures, 2 IBFD TAX RESEARCH SERIES,2015, at.199

Commissionaire agreement is a well-known structures to artificially avoid PE status and it has been a matter of concern for tax authorities and the OECD countries.[33]

Commissionaire agreements exploit the differences between the civil and common law of agency to defend that there is no dependent agent PE where the commissionaire agents concluded the contracts on behalf of the enterprise but in their name.[34] In common law, agents are not liable toward third parties as the contract between the agent and a third party directly binds the principal.[35] Consequently, in common law systems, when the commissionaire agents conclude contracts on behalf of the enterprise but in their name, the agent's activity will constitute a PE for the principal. This would lead to the taxation of the parent company in the source state and the taxation of commission income, which the subsidiary receives for its agent activity.[36] By contrast, in civil law systems, the contract legally binds the principal only if the agent concluded it in the principal's name (direct representation). Indirect representation (whereby the agent contracts in its name but on behalf of his principal) is also possible in these jurisdictions. However, the principal, who is an undisclosed principal, is not liable to the third party; instead, the commissionaire agent is bound by the contract with the third parties.[37] As a result, an enterprise will not have a PE status under the civil law legal system if commissionaire agents conclude contracts on behalf of the enterprise but in the name of the agents.[38]

The tax authorities of European countries have also begun to challenge the commissionaire arrangements.[39] In France, the landmark decision was given in the Zimmer Limited case.[40] The *Zimmer* case is about a French subsidiary that was concluding contracts as a commissionaire in its name but for the account of its UK parent company.[41] Zimmer Limited was a UK tax resident company that distributed its products to the French market through a French resident subsidiary, Zimmer SAS, in a buy-sell structure. In 1995, the group restructured its distribution system to a commissionaire scheme which included the transfer of assets, inventory, and customers' receivables from Zimmer SAS to Zimmer Limited so that the Zimmer SAS only acted as a commission agent following the conversion. However, the French tax authorities (the Administrative Court of Appeal of Paris) ruled that an agency PE was created as the contracts were held to be de facto binding on the parent company and taxed the profit of Zimmer Limited, which was attributable to PE.[42] The group appealed against this conclusion to the Supreme

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[33] Brain J. Arnold, Commentary on Article 5 OECD MC, Global Tax Treaty Commentaries, Amsterdam: IBFD, (2014), at 47ff available at www.ibfd.org(Accessed on July 28, 2021). see also Sheppard Lee, "The Brave New World of the Dependent Agent PE," 17 TAX NOTES INTERNATIONAL,2013, at 10ff

[34] Jiménez, supra note 17, at 6

[35] ARTHUR PLEIJSIER, THE AGENCY PERMANENT ESTABLISHMENT, (UPM, Maastricht, 2000), at19

[36] *Id.*

[37] *Id.*, at 23-24

[38] Balazs Karolyi, The Challenges of Permanent Establishment Concept and the Response of BEPS Actions (Unpublished Master's thesis, Tilburg University,2017), at 36

[39] *Id.*

[40] P-J. Douvier and X. Lordkipanidze, Zimmer Case: The Issue of the Deemed Existence of a Permanent Establishment Based on Status as a Commissionaire, 17(4) INTERNATIONAL TRANSFER PRICING JOURNAL, (2010), at 266.

[41] Jens Wittendorff, Agency Permanent Establishments and the Zimmer Case, INTERNATIONAL TRANSFER PRICING JOURNAL, (2010), at 361

[42] *Id.*

Administrative Court which accepted the substance-over-form approach of tax authorities and decided that the activity of Zimmer SAS has not constituted a PE for Zimmer Limited in France.[43] The decision was based on a strict interpretation of the agency provision of the Tax Treaty between France and the UK, which is similar with paragraph 5 of Article 5 the OECD Model Tax Convention of 2010 that permits a dependent agent to be considered a permanent establishment of its principal if the agent has the authority to conclude legally binding contracts in the name of the principal.[44]

The Norwegian Dell-case[45] is another case on the issues of the commissionaire arrangement. Dell Products was a tax resident in Ireland, and it distributed its goods through Dell AS, which was its Norwegian subsidiary. Dell AS acted as a commissionaire, and the tax authorities considered it as an Agency PE for Dell Products. The group appealed against this conclusion. On March 02, 2011, both the Court of the First Instance (Oslo District Court) and the Borgarting Court of Appeal rejected the tax-payer's appeal and affirmed that Dell Ireland has a PE in Norway.[46] On December 02, 2011, the Norwegian Supreme Court overturned the two previous judgments and stated that Dell Ireland did not have a PE in Norway.[47] The arguments of the Supreme Court were based on the Vienna Convention, Article 5 paragraph 5 of the Norway and Ireland Tax Treaty, the OECD Model Convention and its commentaries, and case laws.[48] The Norwegian Supreme Court affirmed that Dell Ireland did not have any PE in Norway and, consequently, no income should have been assessed.[49]

Under the old version of both the UN and OECD Model Conventions, the conclusion of contracts in the name of the enterprise was mandatory for the dependent agent acting on behalf of an enterprise to constitute a PE.[50] As a result, if the dependent agent negotiated contracts or even concluded the contract on behalf of the enterprise, but in the agent's name, such action of the agent would never give rise to PE.[51] Concerning independent agents, where the independent agent habitually exercises the authority to conclude contracts on behalf of the foreign enterprise, it may not constitute PE except where it acts outside of the ordinary course of its business.[52] Hence, the independent agent may undertake secret dealing and acts on behalf of one or more

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43 *Id*.

44 Sullivan & Cromwell Llp, French Permanent Establishment Tax Decision, 2010. At 1

45 Dell Products v. Tax East, HR-2011-02245-A, December 02, 2011

46 Raffaele Petruzzi, the Norwegian Dell Case and the Spanish Roche Case, 2015, at 2 available at https://www.wu.ac.at/fileadmin/wu/d/i/taxlaw/teaching/Petruzzi_Greinecker_SWI_2012_260.pdf&ve (Accessed on July 28, 2021)

47 *Id*., at4. see also Frederick Zimmer, Norwegian Supreme Court Sides with Taxpayer in Dell Case, TAX NOTES INT'L, 2011, at 771

48 Petruzzi, supra note 46, at 4

49 *Id*.

50 OECD Model Convention, July 22, 2010, (hereafter called OECD Model Convention of 2010), available at https://www.oecd.org/tax/treaties/47213736.pdf and UN model tax convention, 2011, (hereafter called UN Model Convention of 2011), available at https://www.un.org/UN_Model_2011_Update.pdf (Accessed on July 28, 2019)

51 Camilla Berkesten Hägglund, The Definition of a Permanent Establishment in the BEPS Era: An analysis of the Introduction of Commissionaire Structures in Article 5(5) of the OECD Model Treaty, (Unpublished Master's thesis, Uppsala University,2017), at 23

52 see both OECD Model Convention of 2010 and UN Model Convention of 2011, Art.5(6)

enterprises to which it is closely related, in the ordinary course of business, to artificially avoid PE status.[53]

B. Artificial Avoidance of PE Status through the Specific Activity Exemptions

Article 5 (4) of both the OECD and UN Model Conventions has provided a list of activities that do not form PE, though the criterion under Article 5 (1) is fulfilled.[54] It reads that:

> Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include: a) the use of facilities solely for 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 storage, display or delivery; c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for processing by another enterprise; d) the maintenance of a fixed place of business solely to purchase goods or merchandise or of collecting information, for the enterprise; e) the maintenance of a fixed place of business solely to carry 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.

The key idea behind the exemptions is to allow a foreign enterprise to maintain a fixed place of business in the source state "for the storage, display, or delivery of goods without creating a PE there."[55] However, this provision has experienced issues in recent times.[56] Concerning sub (e) and (f), as far as the activities are within the ambit of the lists and auxiliary or preparatory, MNEs can claim this exception irrespective of whether related enterprises undertake those activities at the same place or a different place in the same country. Besides, concerning what is provided under sub-article (a) to (d), the absence of the requirement of auxiliary or preparatory nature of activities may allow the MNEs to conduct their activities in fragmented ways so that it will fall within the specific activity exemption. Hence, MNEs may alter their structures to obtain tax advantages by fragmenting a cohesive operating business into several small operations to argue that each part is merely engaged in preparatory or auxiliary activities or falls within the scope of Sub-article (a) to (d) of Article 5(4).

The OECD has pinpointed two sources of these artificial practices that have specifically caused BEPS concerns for the specific activity exemptions. These are changes in core business activities and the fragmentation of business activities.[57] A development in how cross-border business conducted has dramatically affected how exemptions (a) - (d) operate in practice. The emergence of E-commerce has made it possible for the activities listed in these exemptions,

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[53] Hägglund, *supra* note 51, at 20

[54] See OECD and UN Model Convention of 2017, Art.5(4)

[55] John Gillespie, The Base Erosion and Profit-Shifting Project, Action 7: A Critical Analysis of the Preparatory/Auxiliary Extension and the New Anti-Fragmentation Rule in the 2017 OECD Model Tax Convention, (Unpublished Master's Thesis, Uppsala University, 2018), at15

[56] *Id*., at 14

[57] OECD/G20 Action 7 – Final Report 2015, at 6

based around storage and delivery of stock and the collection of information for business purposes, to become the sole function of a fixed place of business. This allows such a fixed place of business to obtain a PE exemption where it is no longer appropriate in light of the BEPS concerns.[58] In principle, a single enterprise cannot fragment operations among the different fixed places of business to avoid the PE threshold. However, there is an issue when multiple enterprises are organizing and operating a different fixed place of business, but cohesively, as together they may both be able to avoid the PE threshold for the relevant fixed place of business where this would not be so if all fixed place of business were related to just one enterprise.[59]

The benefits offered by specific activity exemption are appealing to no enterprise more so than the 'indirect' E-commerce enterprise, those enterprises that engage in electronic transactions while adopting conventional delivery methods.[60] A case example that can be analysed to demonstrate this is Amazon that has been the focus of much scrutiny during the Action 7 work.[61] For Amazon, which has its headquarters in Luxembourg, the use of specific activity exemptions for source state operations does not always necessarily mean a lower percentage of tax payable but does often mean that the enterprise can attribute more costs against its tax in line with Luxembourg domestic law.[62]

The Amazon UK structure can be analysed as an example of a PE avoidance technique that is replicated across the OECD member states.[63] The structuring of Amazon's UK operation is not extremely complex, but it is important, and its 'fulfilment centres' are critical to the operation as a whole.[64] Following the transfer of Amazon's UK business ownership to Amazon EU SARL in Luxembourg in 2006, the question of whether Amazon EU SARL's activity in the UK created a PE or not emerged.[65] The fulfilment centres, in principle meet the criteria of PE definition as they are fixed places of business through which the business of an enterprise is wholly or partly carried on. However, this fixed place of business purports only to maintain and deliver stock sold on Amazon.co.uk without participating in sales.[66] On this basis, it is reasonably assumed that Amazon UK Services Ltd runs the fulfilment centres with the sole activity of maintaining and delivering stock. Subcontracting the running of warehouses to an independent enterprise while retaining responsibility for conducting online sales is an effective way to separate activity from the sales made on Amazon.co.uk and hence ensure the activity can be deemed as auxiliary.[67]

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[58] Ina Kerschner &Maryte Somare,(eds), Taxation in a Global Digital Economy, 107 SERIES ON INTERNATIONAL TAX LAW,2017, at164

[59] Gillespie, *supra* note 55, at 21

[60] OECD, 'Addressing the Tax Challenges of Digital Economy, Action 1 - Final Report' (2015), at 55

[61] Alex Shephard, 'Is Amazon Too Big to Tax?' (2018), available at https://newrepublic.com/article/147249/amazon-big-tax (Accessed on June 03, 2021)

[62] Gillespie, *supra* note 55, at 22

[63] *Id.*

[64] Kerschner &somare, *supra* note 58

[65] Gillespie, *supra* note 55, at 22

[66] *Id.*

[67] Jean-Louis Medus, 'Digital Business and Permanent Establishment (some critical comments of BEPS' proposals to regulate digital business),' (2015), at 17 as cited in John Gillespie, The Base Erosion and Profit-Shifting Project, Action 7: A Critical Analysis of the Preparatory/Auxiliary Extension and the New Anti-Fragmentation Rule

This may not be accurate; there seems to be a shroud of secrecy surrounding much of Amazon's behavior. Nonetheless, Amazon UK is used as a case example of an operation that could exist under the specific activity exemption. Hence, the example is still valuable in demonstrating the faults of that legal structure.[68]

C. Artificial Avoidance of PE Status through Splitting-up of contracts

Splitting up of contract is another strategy for the artificial avoidance of PE status. Article 5 (3) of both Model Conventions provides that "a building site or construction or installation project constitutes a PE only if it lasts more than 12 months."[69] Sometimes, enterprises may divide their contracts into several parts, each covering a period of less than 12 months, and attribute it to a different company of the same group, thereby avoiding the presence of PE in the host country.[70] Accordingly, if the building or construction project lasted less than 12 months, it does not create a PE irrespective of whether it is undertaken by related enterprises or not. When the threshold is about to exceed, they can hire another company (often a closely related company to the first hired) to undertake construction or building projects, which would wrap up its undertaking without exceeding the threshold.[71] Hence, MNEs may resort to splitting up contracts to avoid the tax they ought to pay to the host country.

III. GLOBAL INITIATIVE ON THE PREVENTION OF ARTIFICIAL AVOIDANCE OF PE STATUS

Base Erosion and Profit Shifting (BEPS) covers tax planning strategies that make use of gaps and mismatches in national tax systems to artificially shift profits to low or no-tax jurisdictions where there is little or no economic activity carried on by the enterprise.[72] The majority of these strategies are legal although they are harmful to the justice of international tax systems as BEPS strategies are only available to MNEs engaging in cross-border business activities, but not to competitors operating purely on the domestic market.[73]

Artificial avoidance of PE status is one of MNEs' techniques for Base Erosion and Profit Shifting (BEPS). As already said, from the 15-point Action Plan developed by G-20 and OECD countries, Action Plan 7 was concerned with the prevention of artificial avoidance of PE status.[74] First, the G-20 countries expressed their concerns about these strategies in 2012 and urged them to address this issue at an international level as the unilateral measures proved not to be effective and may result in double taxation as well.[75] The work started under the aegis of the OECD, and the report that addresses Base Erosion and Profit Shifting was released in 2013.[76] This document

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in the 2017 OECD Model Tax Convention, available at https://www.diva-portal.org/smash/get/diva2:1258757/FULLTEXT01.pdf(Accessed on June 20, 2021)

[68] Gillespie, *supra* note 55, at 23

[69] OECD convention of 2010 and UN Model Convention of 2011, Article 5(3)

[70] Pradeep Kasthala &Partho Dasgupta, Artificial Avoidance of PE status, Relevance of BEPS in the Business Structure,13 INTERNATIONAL TAXATION, 140,2015, at145

[71] *Id*.

[72] Karolyi, *supra* note 38, at 34

[73] *Id.*

[74] OECD Additional Guidance on BEPS Action 7, 2018, at9.

[75] Karolyi, *supra* note 38, at 34

[76] *Id.*

identified BEPS strategies that are available to MNEs under the current system and principles of international tax law. Later on, in 2013, the OECD issued its Action Plan on BEPS in which it stated that they do not intend to change the international tax standards and principles but to restore residence or source taxation where cross-border income would not be otherwise taxed.[77] This document contains the necessary actions to address the identified BEPS strategies, the sources and methodologies that enable the implementation of activities, and the deadlines of these measures.[78]

Different deadlines have been set for the elaboration of different Actions, and at the end of 2015, final versions of all the Action Plans have been prepared.[79] In 2017, the OECD Model Convention was updated based on Action Plan 7 by incorporating the remedies for the prevention of artificial avoidance of PE status.[80] The main step taken in this regard was the amendment of the definition of PE. Besides, the Multilateral Instrument that came into effect based on BEPS Action Plan 15 has also integrated changes to the definition of a PE under its Part Four (Articles 12 to 15).[81] Cognizant to the facts mentioned above, the remedies developed to tackle the artificial avoidance of PE can be summarized as shown below.

As discussed earlier, the commissionaire arrangement has been one of the mechanisms used by MNEs to artificially avoid PE status. OECD Model Convention of 2017 has amended Sub-Articles 5 and 6 of Article 5 of the OECD Model Convention to enable member states to prevent the artificial avoidance of PE through commissionaire arrangement.[82] Under the traditional system, if the dependent agent negotiates or even concludes the contract on behalf of the enterprise but in the name of the agent, it would never give rise to PE, as the conclusion of contracts in the name of the enterprise was mandatory.[83] This was the main loophole for the artificial avoidance of PE status. However, under the new version of the OECD Model Convention, if the dependent agent negotiates contracts or even concludes contracts on behalf of the enterprise, be it in the name of the enterprise or in its name, it would constitute PE.[84] The Multilateral Instrument has also taken a similar approach.[85]

Concerning the independent agent, the activities of independent agents may not constitute PE except when the independent agent acts outside of the ordinary course of its business.[86] The independent agent may undertake secret dealing and acts on behalf of one or more enterprises to which it is closely related in the ordinary course of business to artificially avoid PE status.[87] Currently, when an independent agent acts exclusively or almost exclusively on behalf of one or

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[77] *Id*.

[78] *Id*.

[79] OECD/G20 Base Erosion and Profit Shifting Project Final Reports, Executive Summaries, 2015, available at http://www.oecd.org/ctp/beps-reports-2015-executive-summaries.pdf(Accessed on June 08, 2021)

[80] OECD Model Convention of 2017

[81] Multilateral Convention, Art.12-15

[82] OECD Model Convention of 2017, Art.5 (5) &5(6).

[83] Hägglund, supra note 51, at 23

[84] OECD Model Convention of 2017, Art.5 (5)

[85] Multilateral Convention, Art.12

[86] Hägglund, supra note 51, at 20

[87] *Id*.

more enterprises to which it is closely related, it constitutes a PE irrespective of whether it acts in the ordinary course of business or not.[88] The Multilateral Instrument takes the same position.[89]

The other strategy used by MNEs to artificially avoid PE status is the splitting up of contracts. In doing away with such kinds of conundrums, the Principal Purposes Test (PPT) rule was added to the OECD Model Tax Convention of 2017.[90] Accordingly, if two related enterprises have engaged in particular secret dealing to artificially avoid PE status by splitting their activities with the principal purpose of benefiting from the stipulated threshold, the host states are authorized to either make an appropriate adjustment to the amount of the tax charged therein or any profits may be included in the profits of that enterprise and taxed accordingly.

The Multilateral Instrument also addresses contract-splitting arrangements whereby companies seek to avoid certain timing thresholds to avoid being treated as having a PE.[91] The Multilateral Instrument now provides an aggregation rule for related parties.[92] Where the project or activity does not exceed 12 month period, but the connected activities are carried on at the same construction or installation project during different periods, each exceeding 30 days by one or more enterprises connected to the contractor, such different periods will be added to arrive at the 12-month test. The Principal Purpose Test is also envisaged as a backstop measure against contract splitting.[93]

In doing away with such conundrums related to artificial avoidance of PE status through specific activities exemption and fragmentation of activities, Article 5 (4) of the OECD Model Conventions has devised a mechanism called anti-fragmentation rule under paragraph 4.1 of Article 4.[94] The Anti-fragmentation Rule is designed to prevent an enterprise or a group of closely related enterprises from fragmenting a cohesive business operation into several small operations to argue that each is merely engaged in a preparatory or auxiliary activity.[95] Regarding 'closely related' as contained in this rule, the OECD has inserted a new and separate provision that defines what constitutes a closely related enterprise.[96] Before adopting the Ant-fragmentation Rule, it has been 'relatively easy' for enterprises to continue to abuse the specific exemptions through fragmentation.[97] Some OECD member states have postulated that the new rule is the sole necessary change to effectively resolve the issues that arises from specific activity exemptions. Thus, many states have adopted the new Anti-fragmentation, Rule.[98]

Further, the rationale of the activity exemptions is that these activities are remote from the core income-generating business activity and as such, they do not exceed the threshold which

[88] Article 5(6) of the OECD Model Convention, 2017

[89] See Article 12(2) of the Multilateral Convention &article 5(6) of the OECD Model Convention of 2017.

[90] OECD Model Convention of 2017, Art.9(1)(2)

[91] Samuel Johnston, Multilateral Tax Convention to Prevent Base Erosion and Profit Shifting, 23AUCKLAND UNIVERSITY LAW REVIEW,384, (2017), at 389

[92] The Multilateral Convention, Art.14

[93] The Multilateral Convention, Art.7

[94] OECD Model Convention of 2017, Art.5(4)

[95] OECD Additional Guidance on BEPS action 7,2018

[96] OECD Model Convention of 2017, Art.5 (8)

[97] DANIEL W. BLUM & MARKUS SEILER (EDS), PREVENTING TREATY ABUSE, (Wien Linde Publishing, Series on International Tax Law, Vol.101, 2016), at 391

[98] Gillespie, *supra* note 55, at 29

would justify the taxing right of the source state.[99] However, exempting (and as a result, the PE status is avoided) certain activities that belong to the core activities of the enterprise fall afoul of the principle of fair allocation of taxing rights and gives rise to BEPS strategies.[100] Accordingly, the preparatory/auxiliary provision has been expanded by deletion from the exemptions under (e) - (f) and re-inserted as a separate statement at the end of the provision in such a way as to apply to all six exemptions from (a) - (f).[101] Hence, the mere fact that the core activities undertaken by an enterprise that fall within those lists are not a sufficient condition to claim that exemption; rather, they should be preparatory or auxiliary.

Coming to the Multilateral Instrument, a similar approach is taken with the aforementioned approach under article 5 (4) of the OECD Model Conventions of 2017.[102] Like the new paragraph 4.1 of Article 5 of the OECD Model Conventions, the Anti-fragmentation Rule operates to prevent an enterprise or a group of closely related enterprises from fragmenting cohesive business operations into several small operations to avoid PE status, is adopted.[103] Therefore, for the proper implementation of the Anti-fragmentation Rule, the Multilateral Instrument has provided for the definition of closely related enterprise.[104]

IV. PERMANENT ESTABLISHMENT AND ROOM FOR ITS ARTIFICIAL AVOIDANCE UNDER THE ETHIOPIAN INCOME TAX LAW

A. Room for Artificial Avoidance of PE status Under Ethiopian Income Tax Law

Under Article 4 of the Income Tax Proclamation, PE is defined as "a fixed place of business through which the business of an enterprise is wholly or partly carried on".[105] From this, we can easily understand that the definition given for the term permanent establishment under the Ethiopian tax regime is similar to that of the OECD and UN Model Convention.[106] Though the Ethiopian Income Tax Proclamation defines permanent establishment, it does not provide for what constitutes fixed, place of business, and condition for determining whether the business is carried on through place of business or not. This would inevitably create a certain sort of confusion in determining whether some activities run by non-residents are considered as permanent establishments or not.

Moreover, Article 4(2) of the Income Tax Proclamation provides for a list of activities that constitute PE. Accordingly, a place of management, branch, office, factory, warehouse, or workshop, excluding an office that has representation of the person's business as its sole activity, or a mine site, oil or gas well, quarry, or another place of exploration for, or extraction of, natural resources; or the furnishing of services, including consultancy services is treated as a permanent

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[99] Karolyi, *supra* note 38, at 41
[100] *Id.*
[101] Gillespie, *supra* note 55, at 27
[102] See article 13 of the Multilateral Convention and article 5(4) of the OECD Model Convention of 2017.
[103] Multilateral Convention, Art.13(4)
[104] Multilateral Convention, Art.15
[105] Income Tax Proclamation No.979/2016, Art.4
[106] UN and OECD Model Convention, 2017, Art. 5(1)

establishment.[107] Additionally, Article 4(3) of the same Proclamation stipulates the conditions where a building site or construction, an assembly, or an installation or supervisory activities by non-resident enterprises may constitute PE. Moreover, Articles 4 (4) and 4 (5) of the Income Tax Proclamation deal with the case of agency-related PE.

The Income Tax Regulation has also provided some rules regarding PE.[108] It provides additional rules on service-related permanent establishment, particularly when it is a connected project of the person or a related person.[109] It also provides rules on the construction or building permanent establishment when it is a connected project of the person or a related person.[110] Compared to the repealed income tax proclamation, the new Income Tax Proclamation has made a change of approach. Though both proclamations have similarly defined the term PE, Article 2(9) (b) of the repealed proclamations has provided a list of auxiliary or preparatory activities that cannot be considered as PE, while the new income tax proclamation has excluded such list.[111] From the aforementioned facts, it is clear that the Ethiopian Income Tax Proclamation and regulation have provided detailed rules on PE. Yet, the way the definition of PE is articulated under Ethiopian income tax law opens room for MNEs to avoid PE status. Accordingly, the rooms for artificial avoidance of PE status under the Ethiopian income tax law are presented as follows.

B. Artificial avoidance of PE through commissionaire arrangement

As discussed above, one of the strategies the MNEs have been using for artificial avoidance of PE status is using a commissionaire arrangement either through a dependent or independent agent. Article 4(4) of the Income Tax Proclamation provides for the case of dependent agency permanent establishment. It stipulates that when a person, other than an agent of independent status acting in the ordinary course of business, regularly negotiates contracts on behalf of another person (the principal) or maintains a stock of goods from which the person delivers goods on behalf of the principal, the agent is the PE of the principal.[112] From this, it is clear that when the dependent agent, acting in ordinary courses of the business, regularly negotiates the contracts on behalf of the principal, such a dependent agent is the PE of the principal. One of the rooms for artificial avoidance of PE status was that for the dependent agent that acts on behalf of the principal to give rise to PE, the conclusion of contracts on behalf of the principal was mandatory.[113] That means negotiation of the contracts on behalf of the principal would never give rise to PE. Accordingly, recognizing regular negotiation of contract on behalf of the principal as a condition that gives rise to a PE can be taken as a good change introduced by the

[107] Income Tax Proclamation No.979/2016, Art. 4 (2) (a, b, c)
[108] Income Tax Regulation No.410/2017, Art. 4
[109] *Id*., at Art. 4(1)
[110] *Id*., at Art. 4(2)
[111] See *Federal Income Tax Proclamation of Ethiopia*, Proclamation No. 286/2002, FED. NEGARIT GAZETA, Year 8, No.34, (2002) (hereafter Income Tax Proclamation No. 286/2002), Art.2(9) and Income Tax Proclamation No. 979/2016, Art. 4
[112] Income Tax Proclamation No. 979/2016, Art. 4 (4)
[113] Hägglund, *supra* note 51, at 23

Income Tax Proclamation, which is in line with the countermeasures that have been taken under the OECD Model Tax Convention and the Multilateral Instrument.

However, concerning whether the conclusion of the contracts on behalf of the principal would give rise to PE or not, Article 4(4) of the Income Tax Proclamation is not clear due to its silence on this aspect. The dependent agent can go beyond negotiation and conclude the contract on the principal's behalf. This would pose another question as to whether it is the intention of the Income Tax Proclamation or legislator to exclude the conclusion of the contract on behalf of the principal from creating PE or if it is incidentally excluded. What makes things difficult is that both Amharic and English versions of Income Tax Proclamations are silent on whether the conclusion of contracts on behalf of the principal would give rise to PE or not.

On the other hand, under the repealed Income Tax Proclamation of Ethiopia, it is the only conclusion of the contracts on behalf of the principal that would give rise to PE.[114] The same was true under the old version of the UN and OECD model convention. This was among the triggering factors for the OECD and G-20 countries to develop BEPS action, which recognizes both the conclusion and negotiation of a contract on behalf of the principal as a condition giving rise to PE.[115]

Accordingly, MNEs may claim the absence of a conclusion of the contract on behalf of the principal pursuant to Article 4(4) of the new Income Tax Proclamation to defend artificial avoidance of permanent establishment status. Hence, had the Ethiopian Income Tax Proclamation explicitly provided both the conclusion and negotiation of contracts on behalf of the principal as a condition for the creation of PE, it would have been more meaningful.

Again, the silence of the Income Tax Proclamation on the conclusion of the contract on behalf of the principal would beg for another question. As it has been discussed above, one of the rooms for artificial avoidance of PE status is that for the conclusion of the contracts on behalf of the principal to give rise to PE, it should be made in the name of the principal. That means the conclusion of contracts on behalf of the principal but in the name of the agents would never give rise to PE.[116] The same is true under the repealed Income Tax Proclamation of Ethiopia.[117] Under the BEPS action plan, one of the countermeasures that taken against this backdrop is that the conclusion of contracts on behalf of the principal would give rise to PE irrespective of whether it is made in the name of the principal or agents.[118]

Generally, the absence of the conclusion of contracts on behalf of the principal from article 4(4) of the Income Tax Proclamation and the absence of clarification as to whether or not an agent ought to conclude the contracts by the name of the principal or its name would inevitably create confusion. Even though Article 4(4) of the Income Tax Proclamation provides the negotiation of contracts on behalf of the principal as one of the conditions to constitute PE, it is

[114] Income Tax Proclamation No.286/2002, Art. 2 (9) (c)
[115] OECD Model Convention of 2017, Art.5 (5)
[116] Hägglund, *supra* note 51, at 23
[117] Income Tax Proclamation No.286/2002, Art. 2 (9) (c)
[118] OECD Model Convention of 2017, Art. 5 (5)

silent as to whether the negotiation of contracts should be made in the name of the principal or agents.

C. Artificial avoidance of PE status through splitting up of contracts and specific activity exemption

According to Article 4(3) of the new Income Tax Proclamation, it is stated that a building site, a construction, assembly, or installation project, or supervisory activities connected with such site or project shall be considered as PE only when the site or project or activities continue for more than 183 days. It is also provided under Article 4(2(c) of the Income Tax Proclamation that furnishing of services, including consultancy services, would create a PE only when the activities of that nature continue for the same or connected project for a period or period aggregating more than 183 days in any one year. As they stand, the stipulations of the Income Tax Proclamation would enable MNEs to artificially avoid PE status by splitting their contracts among related parties to avoid the 183 days threshold. However, the Income Tax Regulation has provided the remedy against artificial avoidance of PE status that could happen in the face of these provisions of the income tax proclamation. Article 4 (2) of the regulation provides that:

> When a person operates a building site or conducts a project or activity referred to in Article 4 (3) of the Proclamation, any connected activities conducted by a related person shall be added to the period during which the first-mentioned person has operated the building site or conducted the project or activities to determine whether the 183 days is exceeded.[119]

From this article, it is clear that concerning building or construction PE, in determining the 183 days threshold, the period spent on building or construction and any connected activities by a related person should be added up. Accordingly, if two related enterprises undertake certain secret dealing in a way that enables them to artificially avoid PE status by splitting their activities with the principal purpose of benefiting from the threshold, they cannot succeed since the tax authority is authorized to add up the periods spent on any connected activities conducted by a related person. Accordingly, Article 4 (1) of the regulation provides that "in determining whether a person exceeds the 183 days specified in Article 4 (2) (c) of the Proclamation, account shall be taken of a connected project of the person or a related person.[120] Like that of construction or building PE, if certain secret dealing is made to artificially avoid PE status by splitting services with the principal purpose of benefiting from the threshold, the tax authority is authorized to consider the periods by the connected project of a person or the related person to fight artificial avoidance of PE status.

However, the absence of a definition for what constitutes connected activities or connected service projects under the Income Tax Regulation would inevitably create confusion. Unless we define what constitutes connected activities or connected service projects, it is quite difficult for the tax authority to consider or add up the periods by the connected project or activities of related person. MNEs may raise a defence that their activities or project is not connected, and hence, the tax authority should not add up the period spent on unrelated activities or projects to determine

[119] Income Tax Regulation No.410/2017, Art. 4 (2)
[120] Income Tax Regulation No.410/2017, Art. 4 (1)

the threshold. In this aspect, the OECD Model Convention has clarified such controversial terms through commentary.[121] The same is true for the UN Model Convention.[122] Hence, the failures of the Ethiopian Income Tax Regulation to define what constitutes connected activity or service project would inevitably allow MNEs to defend artificial avoidance of PE status.

Another avenue by which the non-resident person has been and still avoiding PE status is based on the specific activity exemption. As it has been discussed, artificial avoidance of PE status through specific activity exemption is claimed based on the list of activities that do not constitute PE. The new Income Tax Proclamation has avoided a list of activities that do not constitute a PE. This could be taken as the positive aspect of the Ethiopian income tax proclamation as it closes the door or the room that lets the MNEs artificially avoid a PE status through specific activity exemption.

D. Other rooms for artificial avoidance of PE status

It is a truism that international business trends are changing from the physical environment to electronic commerce. Ethiopia does not have legislation on the taxation of cross-border E-Commerce. Besides, no provision of the Income Tax Proclamation and regulation of Ethiopia has provided for the taxation of electronic commerce. This would take us to the general rules for the taxation of non-resident persons under the Ethiopian income tax laws. It is a principle of Ethiopian income tax law that tax is levied on profits derived by a foreign business or non-resident person if and only if the concerned non-resident person maintains a PE and only to the extent that the profits are attributable to Ethiopia.[123] One of the fundamental elements for a permanent establishment is a geographical, physical location for the business to operate, which is extremely difficult to determine when the business has carried out only by electronic means.[124] The same is true under the Ethiopian Income Tax Proclamation.[125] Hence, MNEs may resort to electronic commerce to artificially avoid PE status.

Another room for artificial avoidance of PE status under the Ethiopian income tax laws has been attributed to the absence of the definition for the term "place of management.'' Article 4(2) (a) of the Income Tax Proclamation provides that "place of management'' is one of the elements to determine whether the non-resident enterprise has a permanent establishment or not.[126] Further, Article 5(5) (b) of the same proclamation provides an "effective place of management" as a requirement in determining whether the given body is a resident or not.[127] Again, the proclamation has not defined what constitutes an effective place of management. Accordingly, it

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[121] OECD Model Convention commentary paragraph 42.41.

[122] UN, Committee of Experts on International Cooperation in Tax Matters Eleventh Session, Article 5 (Permanent establishment): The meaning of "connected projects**,** 2015, available at https://www.un.org/esa/ffd/wpcontent/uploads/2015/10/11STM_CRP9_Article5_marked.pdf&ved (Accessed on June 12, 2021)

[123] Income Tax Proclamation No.979/2016, Art.4

[124] Castro, *supra* note 1, at 150

[125] Income Tax Proclamation No.979/2016, Art. 4(1).

[126] Income Tax Proclamation No.979/2016, Art, 4 (2) (a).

[127] Income Tax Proclamation No.979/2016, Art, 5 (5) (b)

is difficult to put the line of demarcation between the place of management and the effective place of management. Hence, MNEs may use such gaps to artificially avoid PE status.

V. ROOM FOR THE ARTIFICIAL AVOIDANCE OF PE STATUS UNDER THE DOUBLE TAXATION AGREEMENT OF ETHIOPIA

Ethiopia has been exerting efforts to attract foreign direct investment.[128] The measures taken by Ethiopia towards attracting FDI include signing bilateral investment treaties (BITs) and double tax avoidance agreements.[129] With the primary objective of fighting double taxation and fiscal evasion, Ethiopia has taken unilateral measures such as foreign tax credits.[130] In addition to the unilateral measures, Ethiopia has signed several bilateral double tax avoidance agreements with various countries. Accordingly, Ethiopia has signed more than 32 bilateral double-taxation agreements with other countries.[131]

However, the status of the double taxation agreements differs in that some of the double taxation agreement is ratified by the two governments, and the ratification document is exchanged between the parties, while the Ethiopian government ratifies others, and the rest are just signed by the respective higher official of the two governments.[132] There are only 11 double taxation agreements, which became effective on ratification by both governments and the exchange of the instrument of ratification.[133] The double taxation agreements between the FDRE and Italy, Egypt, India, Sudan, China, the French Republic, Turkey, the United Kingdom of Great Britain and Northern Ireland, Kingdom of Netherlands, Kingdom of Saudi Arabia, and the Republic of Ireland are in force at this time. From a legal point of view, these are the only double taxation agreements that are binding on Ethiopia and its counterparts.[134] Besides, the Ethiopian government has ratified the other 13 double taxation agreements.[135] Such double taxation agreements are not binding on Ethiopia since the Ethiopian government does not have any information as to the status of the double taxation agreement on the side of the other State.[136] The rest, around eight double taxation agreements, have been signed but not ratified.[137] The scrutiny of all-bilateral double taxation agreements reveals that Ethiopia has signed these bilateral double taxation agreements per OECD Model Tax Treaty.[138]

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[128] Martha Belete Hailu & Tilahun Esmael Kassahun *'Rethinking Ethiopia's Bilateral Investment Treaties in light of Recent Developments in International Investment Arbitration'*,8(1) MIZAN LAW REVIEW, 117, 2014

[129] *Id*.

[130] Income Tax Proclamation No.979/2016, Art.45

[131] Serkalem, *supra* note 15, at.35

[132] *Id*.

[133] *Id.*

[134] *Id*.

[135] Double taxation agreements between the FDRE government and Kuwait, Russian Federation, Yemen, Algeria, Tunisia, Romania, South Africa, Israel, Czech Republic, Seychelles, Portugal, Peoples Democratic Republic of Korea, and United Arab Emirates are ratified.

[136] Serkalem, *supra* note 15, at 35

[137] Double taxation agreements between the FDRE government and Palestine, Poland, Cyprus, Qatar, South Korea, Slovakia, Morocco, and Singapore are signed but not ratified.

[138] Aschalew Ashagre, *A Note on Resolution of Tax Disputes Arising from DTTs and Implications for Developing Countries,* 13(3) MIZAN LAW REVIEW,495,2019, at 513

One of the key concerns of a bilateral double taxation agreement is PE. Accordingly, the issue as to whether the double taxation agreements signed by Ethiopia have adequately prevented artificial avoidance of permanent establishment status or not is of the essence. All of the double taxation agreements signed by Ethiopia have a detailed rule on the permanent establishment. The structure of Ethiopia's double taxation agreement is more or less the same since Ethiopia has its own Tax Treaty Model that has presented to the other party when the need arises.[139] Accordingly, Article 5 of all double taxation agreements Signed by Ethiopia has defined a permanent establishment in similar Ways.

Being cognizant of this, the issues as to whether PE, as envisaged under the double taxation agreements concluded by Ethiopia, opens the room for artificial avoidance of PE status or not are analysed below.

A. Artificial avoidance of PE status through commissionaire arrangement or similar strategies

As it has been discussed, Article 5 of all double taxation agreements signed by Ethiopia has a detailed rule on PE. Yet, PE is loosely defined, and it may let MNEs artificially avoid PE through a commissionaire arrangement. Article 5(5) of all double taxation agreements signed by Ethiopia has provided for the case of dependent agency PE.[140] It provides that when the dependent agent acts on behalf of a principal and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the principal's name, the principal shall be deemed to have a PE in that State.[141] From this provision, it is clear that for the acts of the dependent agent to create PE for the principal, the conclusion of the contract on behalf of the principal in the name of the principal is mandatory. This means that negotiation by the agent of contracts on behalf of the principal or the conclusion of contracts on behalf of the principal, but in the name of the agent, would never give rise to PE. Accordingly, MNEs may let the dependent agent either act by its name or negotiate contracts on behalf of them to artificially avoid PE status.

Again, Article 5(6) of all double taxation agreements signed by Ethiopia has provided for the independent agent. It provides that if the independent agent acts wholly or almost wholly for the enterprise, whether the enterprise for which it takes to charge is a related enterprise or not, it would give rise to a PE.[142] The way the issue of independent agents is articulated under the double taxation agreement of Ethiopia is quite good. When the independent agent acts wholly or almost wholly for the enterprise, it will give rise to PE irrespective of whether the enterprise it takes charge of is a related enterprise or not. Accordingly, there is no room for artificial avoidance of PE under the guise of independent agency PE. This is the positive aspect of all

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[139] Serkalem, *supra* note 15, at36

[140] See article 5(5) of double taxation agreements between the FDRE government and Kuwait, Russian Federation, Yemen, Algeria, Tunisia, Romania, South Africa, Israel, Czech Republic, Seychelles, Portugal, Peoples Democratic Republic of Korea, United Arab Emirates, Palestine, Poland, Cyprus, Qatar, South Korea, Slovakia, Morocco, Italy, Egypt, India, Sudan, China, the French Republic, Turkey, United Kingdom of Great Britain and Northern Ireland, Kingdom of Netherlands, Kingdom of Saudi Arabia, and the Republic of Ireland and Singapore.

[141] *Id.*

[142] see Art.5(6) of all double taxation agreements signed by Ethiopia

double taxation agreements of Ethiopia as it closes the room for artificial avoidance of permanent establishment status under the guise of independent agency commissionaire arrangements.

B. Artificial avoidance of PE status through Splitting up of contracts

As it has been discussed, one of the strategies for artificial avoidance of permanent establishment status is through splitting up of contracts. Concerning splitting up of contracts as strategies for artificial avoidance of PE status, article 5(3) of all double taxation agreements signed by Ethiopia provide that "A building site or construction or installation project constitutes a PE only if it lasts more than 6 months".[143] If the building or construction project lasted less than 6 months, it does not create a PE irrespective of whether it is undertaken by related enterprises or not. This would open the room for artificial avoidance of PE status as enterprises may divide their contracts into several parts, each covering a period of less than 6 months, and attribute it to a different company of the same group, thereby avoiding the presence of PE in the host country. Accordingly, all double taxation agreements signed by Ethiopia have not managed artificial avoidance of permanent establishment status through splitting up of the contract.

C. Artificial avoidance of PE status through Specific activity exemption

Concerning artificial avoidance of PE through specific activity exemption, Article 5 (4) of all double taxation agreements signed by Ethiopia has provided a list of activities that cannot be deemed PE from "a" to "f".[144] As discussed, with the primary purpose of fighting artificial avoidance of PE status, some countries have adopted the anti-fragmentation rule while others have excluded the list of activities that cannot be deemed PE. However, under all double taxation agreements signed by Ethiopia, nothing is provided to manage artificial avoidance of PE status through specific activity exemption. It has neither avoided the list of activities that cannot be deemed PE nor adopted the anti-fragmentation rule. Accordingly, MNEs that work in Ethiopia may undertake certain activities in a fragmented way so that it will fall within the exception and thereby artificially avoid PE status.

VI. CONCLUSION AND RECOMMENDATIONS

Weaknesses in the outdated international tax rules have created opportunities for base erosion and profit shifting. One of the prominent avenues or strategies by which multinational enterprises have been using to escape the payment of tax is the artificial avoidance of PE status. This is attributed to the loopholes concerning the definition of PE. Accordingly, Artificial avoidance of PE status through commissioning arrangements, specific activity exemptions, and splitting up of contracts concerning construction or building projects and service PE are the prominent strategies multinational corporations have been using to artificially avoid PE status.

The main step G-20 countries and the OECD take to tackle the artificial avoidance of PE status is changing the way the definition of PE is provided under article 5 of the OECD Model Conventions. This change has already been incorporated into the OECD Model Conventions of

[143] See Article 5(3) of all double taxation agreements signed by Ethiopia.
[144] See Article 5(4) of all double taxation agreements signed by Ethiopia.

2017 and the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base erosion and profit shifting.

Coming to the context of Ethiopia, sufficient countermeasures are not taken against artificial avoidance of PE status. Prominently, artificial avoidance of PE status concerning dependent agency PE, which falls within the commissionaire arrangement, is not tackled. The same is true for artificial avoidance of PE status concerning construction or building and service PE. However, the Ethiopian income tax regulation has adopted the aggregation rule, and the absence of any parameter for ascertaining whether the given construction or building activities are connected activities and whether the given service projects are connected or not would inevitably open the room for artificial avoidance of PE through splitting up of contracts.

Coming to bilateral double taxation agreements signed by Ethiopia, saving for artificial avoidance of PE status through the independent agent that incidentally regulated, all double taxation agreements are devoid of the remedies of artificial avoidance of PE status. Accordingly, no countermeasure has been taken against the artificial avoidance of PE status through a commissionaire arrangement, specific activity exemption, and splitting up of the contract. Whatever it may be, the main question is what would be expected of Ethiopia in preventing the artificial avoidance of PE status since all of the double taxation agreements are ignorant of remedies for artificial avoidance of PE status via commissionaire arrangement, specific activity exemption, and splitting up of contracts concerning building and construction project or service PE. Accordingly, Ethiopia should renegotiate, terminate, or amend its double taxation agreement in line with OECD Model Conventions or Multilateral Instrument developed by the OECD and G-20 countries to prevent base erosion and profit shifting. What makes things better is that all double taxation agreement has a termination clause. Based on the conclusion mentioned above, my recommendations comprised of the followings:

- ✓ First, the scope of agency PE should be expanded so that it will be a panacea solution for the artificial avoidance of PE status via a commissionaire arrangement. Particularly, sub (a) of Article 4(4) of the new income tax proclamation should be replaced with "regularly concludes or negotiates contracts on behalf of the principal either by the name of the principal or agents."
- ✓ Though an attempt was made to fight the artificial avoidance of PE status via the splitting up of contracts, the Ethiopian income tax law still has a ream loophole for the artificial avoidance of PE status. Hence, it is recommendable to provide what constitutes connected projects or activities for construction or building and service PE. Specifically, I recommend Ethiopia to adopt the definition that was given for the connected project by the Committee of Experts on International Cooperation in Tax Matters in its Eleventh Session in 2015. Accordingly, the following sub-articles should be added under article 2 of the income tax proclamation.
    1. “Connected project” is intended to cover cases where, even though the services are provided in the framework of separate projects, those projects are carried on by a single supplying enterprise and are commercially connected.

2. The project is said to be connected project when:
   a. The projects are covered by a single master contract
   b. The contracts covering the different projects were concluded with the same person or related persons;
   c. The conclusion of additional contracts with a person is a logical consequence of a previous contract concluded with that person or related persons;
   d. The nature of the services provided under the different projects is the same or similar; and
   e. The same individuals engaged by the enterprise are performing the services under the different projects

- ✓ Finally, since all the double taxation agreements of Ethiopia have room for artificial avoidance of PE status, it is recommendable for Ethiopia to revisit its double taxation agreements and integrate the countermeasures for artificial avoidance of PE status either through renegotiation, amendment, or termination.

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