Major Problems Associated with Rules on Permanent Establishment under Ethiopian Income Tax Law

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Abstract

The allocation of taxing rights between the states with respect of business profits is a very complex activity. The central notion of the allocation rules is the Permanent Establishment (PE). However, owing to the gaps or mismatches that attributed to the definition of PE as envisaged under tax treaties and national laws, base erosion and profit shifting became an international agenda. This article examines the concept of PE as defined under the Ethiopian income tax law, identifies its shortcomings and explores opportunities for proper regulation. To this end, it employed doctrinal legal research method to investigate the pertinent provision of income tax law. Accordingly, the finding of the paper shows several pitfalls of Ethiopian income tax regime concerning permanent establishment. Absence of definition for the elements of a permanent establishment, total disregard of permanent establishment concerning E-Commerce, and its failure to manage artificial avoidance of permanent establishment status are among the major problems. Furthermore, absence of any clarification concerning a place of management and effective place of management, which is provided as a requirement for determining whether a foreign enterprise has a permanent establishment or a resident respectively, and absence of exceptions for the interruption of activities via force majeure in relation to construction or building and service permanent establishment are other problems of Ethiopian income tax law. Accordingly, multinational corporations may resort to base erosion and profit shifting by using the gaps that are left by Ethiopian tax regime. Hence, Ethiopian income tax law should be amended in a way that solves the aforementioned lacunas.

Keywords: Permanent establishment, electronic commerce, artificial avoidance, effective place of management.

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Introduction

The growth of the international trade and investment, just after the First World War, has created a vast expansion of business across borders posing a new challenge in the taxing power of governments.[1] Both countries where the business was established and the country where the business is conducted face the problem (which is also known as the double taxation problem) of taxing the same business activities.[2] As the problem undermines the expansion of international business, it is crucial to find a solution to the problem. After a number of efforts, it was finally decided that tax on profits should be based on the permanent establishment rule where the source country should tax profits derived from a foreign business if the permanent establishment of the business exists in the host country.[3]

The existence of a permanent establishment is a requirement for a country to tax non-resident's business profits derived from sources in that jurisdiction.[4] As stipulated under both the OECD and UN Model Conventions, a source country should tax profits derived by a foreign business if and only if the enterprise maintains a PE and only to the extent that the profits are attributable to the PE in that country.[5] Hence, the main use of permanent establishment is to determine the right of a Contracting State to tax the profits of an enterprise of the other Contracting State.[6] Once, it has been established that a permanent establishment exists; the profits of the permanent establishment must be calculated based on the arms-length principle.[7]

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[1] Susan C. Borkowski, Electronic Commerce, Transnational Taxation and Transfer Pricing: Issues and Practices, *International Tax Journal*, Vol .28, No.2, (2002). Pp.1-36.

[2] Arthur J. Cockfield, Balancing National Interest in the Taxation of Electronic Commerce Business Profits, *Tulane Law Review*, Vol .74, No.1, (1999), p. 133.

[3] *Id.*

[4] Cormac Kelleher, Problems with Permanent Establishments, TTN Conference, Prague, (2009), p.1.

[5] OECD Model Convention, 2017 update, Art. 7(4), (hereafter called OECD Model Convention) available at https://www.oecd.org/ctp/treaties/2017-update-model-tax-convention.pdf.land UN Model Convention, 2017update, Art.7(4), (hereafter called UN Model Convention) available at https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf last accessed on 03July 2019. From article 7(4), we can easily surmise that the competency of the host states to impose taxes on non-resident persons that derived profits or income from their country is determined via permanent establishment. Accordingly, non-resident enterprises that derived income from the host country are subjected to taxes if and only if it undertakes business activities in the forms of permanent establishment.

[6] Aiko Nakayama, The Permanent Establishment Concept Under Tax Treaties and Its Implications for Multinational Companies, Master's thesis, University of London, (2012), p.27

[7] Commentary on OECD Model Convention of 2017 update, paragraph 16 to Art.7(here in after called commentary on OECD Model Convention) available at https://www.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2017_mtc_cond-2017-enlast accessed on 03July 2019

Defining what constitutes a permanent establishment is critical for hosting countries to identify whether a certain non-resident enterprise is subject to tax within their territory or not. However, there is no a universally accepted definition so far in the literature. According to paragraph 1 of Article 5 of both OECD and UN Model Tax Convention, a permanent establishment is "a fixed place of business through which the business of an enterprise is wholly or partly carried on".[8] Besides, article 5(2), 5(3), 5(4), 5(5) and 5(6) of both the OECD and UN Model Conventions have provided for the list of activities that constitutes permanent establishment, list of activities that cannot be deemed to be permanent establishment, conditions when construction or building project by non-resident constitutes permanent establishment, and agency permanent establishment, respectively.[9]

Two types of a permanent establishment are contemplated by Article 5 of both OECD and UN Model Tax Conventions. The first type of a permanent establishment is associated with the permanent establishment which is part of the same enterprise and under common ownership and controls like an office and branch.[10] The second type of a permanent establishment is an unassociated permanent establishment. This type of permanent establishment involves an agent who is legally separate from the enterprise but is nevertheless dependent on the enterprise to the point of forming a permanent establishment.[11] Yet, the advent of E-Commerce provides a new way of conducting commercial transactions in today's global market. As E-Commerce has sparked considerable debate over the continued viability of the PE rules, numerous reform suggestions have appeared in the tax policy and law literature.[12]

Coming to the context of Ethiopia, the way the issue of permanent establishment is approached under the repealed proclamation number 286/2002[13] is quite

[8] OECD and UN Model Conventions, Art.5 (1). Both UN and OECD Model Conventions have defined permanent establishment in similar ways. Yet, they have slight differences concerning activities that constitute a permanent establishment, and duration of activities to qualify for a permanent establishment in case of construction, building, and service permanent establishment.

[9] *Id.,* Art. 5(2)-5(6).

[10] Philip Baker, Double Taxation Conventions: A Manual on the OECD Model Tax Convention on Income and Capital, Third Edition, Thomson/Sweet & Maxwell, London, (2009), p .5.

[11] *Id.*

[12] Benjamin Hoffart, Permanent Establishment in the Digital Age: Improving and Stimulating Debate through an Access to Markets Proxy Approach, *North Western Journal of Technology and Intellectual Property*, Vol.6, No..1 (2007), p. 112.

[13] Federal Income Tax Proclamation of Ethiopia, Proclamation No. 286/2002, *Federal Negarit Gazetta*, Year 8, No.34, (2002) (here after Income Tax Proclamation No.286/2002) The New Federal Income Tax Proclamation no 979/2016 was issued, repealing Income Tax Proclamation No 286/2002, Petroleum Income Tax Proclamation No 296/1986 and Mining Iincome Tax Proclamation no 53/1993 with their subsequent amendments.

distinct from the current income tax proclamation number 979/2016[14]. Compared to the repealed proclaimation, the current income tax proclaimation has made a change of approach. However,, both the repealed and current Income Tax Proclamations have defined the term PE in similar ways; the repealed proclamation considered a PE as a resident person while the current income tax proclamation have regulated both PE and a resident person separately.[15] Again, article 2(9) (b) of the repealed proclamation has provided for a list of auxiliary or preparatory activities that cannot be considered as PE while the current income tax proclamation has excluded it.[16] Furthermore, in relation to agency permanent establishment, the repealed proclamation provided that the negotiation of contracts on behalf of the principal would never give rise to PE as the conclusion of contracts on behalf of the principal is mandatory.[17] But, under the current proclaimation, the negotiation of contracts on behalf of the principal would give rise to PE.[18]

The new income tax proclamation number 979/2016 has defined permanent establishment as "a fixed place of business through which the business of an enterprise is wholly or partly carried on''.[19] From this article, we can easily understand that the definition given to the term permanent establishment under the Ethiopian income tax regime is similar to that of the OECD and UN Model Conventions.[20] Besides, article 4(2) of the same proclamation provides for a list of activities that constitutes permanent establishment while article 4(3) provides for when construction or building project by nonresident enterprises constitutes a permanent establishment. Furthermore, Article 4(4) and 4(5) of the same proclamations have provided for agency permanent establishment. From the aforementioned facts, we can easily understand that both associated and unassociated types of the permanent establishment are recognized under article 4(2), and article 4(4) (5) of income tax proclamation number 979/2016, respectively. The income tax regulation of Ethiopia has also provided some issues on PE.[21] Though the Ethiopian income tax law defined the term

[14] Federal Income Tax Proclamation of Ethiopia, Proclamation No. 979/2016, *Federal Negarit Gazetta*, year 22 No.104, (2016), (hereafter called Income Tax Proclamation No.979/2016).

[15] See Income Tax Proclamation No.286/2002, Art.5 (4) and Income Tax Proclamation No.979/2016, Art. 4.

[16] Income Tax Proclamation No.286/2002, Art. 2(9) (b).

[17] Income Tax Proclamation No.286/2002, Art. 2(9) (c).

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

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

[20] See Art.4 of the Income Tax Proclamation No.979/2016, and Art.5(1) of both UN and OECD Model Conventions.

[21] Federal Income Tax Regulation of Ethiopia, Regulation No. 410/2017, *Federal Negarit Gazeta,* 23rd Year, No.82, 2017 (hereafter called Income Tax Regulation No.410/2017), Art. 4.

permanent establishment so that it enables the tax authority to determine whether the nonresident enterprise is subject to taxes or not, various problems underlie the permanent establishment as provided under income tax law of Ethiopia. Currently, the traditional business trend which requires the physical presence is replaced with virtual business transaction. This paradigm shift would inevitably pose a challenge to the Ethiopian rule of permanent establishment. Besides, absence of clarification on some terminologies, and the issue of artificial avoidance of permanent establishment status that emerged as the new perspective to permanent establishment is another conundrum of the Ethiopian rules of permanent establishment. Such perplexities would open the room for base erosion and profit shifting, and then result in the loss of revenue for Ethiopia.

The aim of this article is, therefore, to examine the concept of PE as defined under the Ethiopian income tax law, to identify its shortcomings and to explore opportunities for proper regulation. To this end, doctrinal legal research methodology is employed to investigate the pertinent provision of income tax law of Ethiopia.

The article is divided into 4 sections. This first section provided introduction to the subsequent sections. The second section presents the general overview of permanent establishment. The third section explores permanent establishment as envisaged under the Ethiopian income tax law in lights of OECD and UN Model Convention. The fourth section analyzes major problems associated with permanent establishment under the Ethiopian income tax law. Finally, the article comes to an end with brief concluding remarks.

1. General Overview of Permanent Establishment.

The first approach to the Permanent establishment concept dates back to 1899 when Austria-Hungary and Prussia signed a tax treaty, which required a fixed place of business for the taxpayer to be liable in the source country.[22] Then, in 1927, it was enshrined in the model tax convention of the League of Nations (1927) and the modern notion was adopted by the Organization for the Economic Cooperation and Development ("OECD") tax Model Convention of 1963.[23]In 1927 a draft convention on double taxation by the League of Nations defined permanent establishment as "real Centre's of management, mining and

[22] Arvid Age. Skaar, *Permanent Establishment: Erosion of Tax Treaties Principle*, Kluwer Law and Taxation, (1991), p.65

[23] Cockfield, *supra* note 2.

oil fields, factories, workshops, agencies, warehouse, office, and depots".[24] Since then, permanent establishment has been used as a demarcation point to tax profits from business to overcome the problem of double taxation for non-resident taxpayers.[25] Accordingly, many countries have adopted the OECD model on the determination of permanent establishment in formulating their own guidelines. Originally, the permanent establishment principle was introduced mainly to avoid conflicts between countries and to avoid companies doing business in another jurisdiction being imposed tax twice. The principle of permanent establishment has been used to justify the fact that a contracting country foregoes its right to charge income in its jurisdiction[26]and to enable the other country to practice its right of taxing the profits attributable in its jurisdiction.[27]

Essentially, permanent establishment determines the right of a contracting state to tax the profits of an enterprise of the other contracting state. The definition of permanent establishment is used in bilateral tax treaties to determine the right of a State to tax the profits of an enterprise of the other State.[28] Specifically, the profits of an enterprise of one State are taxable in the other State if and only if the enterprise maintains a permanent establishment in the latter State and only to the extent that the profits are attributable to the permanent establishment.[29] If an enterprise fails to qualify as a permanent establishment, its profits will be exempted from income tax in the country of source and would only be subject to fiscal compliance in the country of residence.[30]

The concept of permanent establishment marks the dividing line for business between merely trading with a country and trading in that country.[31] If an enterprise has a permanent establishment, its presence in a country is sufficiently substantial that it is trading in the country. The main use of the concept of a permanent establishment is to determine the right of a Contracting State to tax

[24] Randolph J. Buchanan, The New Millennium Dilemma: Does Reliance on the Use of Computer Servers and Websites in a Global Electronic Commerce Environment Necessitate a Revision to the Current Definition of a Permanent Establishment, *SMU Law Review,* Vol .54, No.4, (2001), p. 2115.
[25] Cockfield, *supra* note 2.
[26] John K. Sweet, Formulating International Tax Laws in the Age of Electronic Commerce: The Possible Ascendancy of Residence-Based Taxation in an Era of Eroding Traditional Income Tax Principle, *University of Pennsylvania Law Review*, Vol.146, No.6, (1998), p.1949.
[27] Zaleha Othman &Mustafa Mahad Hanefah, Taxation of E-Commerce and Determination of Permanent Establishment, Malaysian *Accounting Review*, Vol.5, No.2, (2006), p.3.
[28] UN Model Convention, Art.7(1).
[29] *Id.*
[30] *Id.*
[31] Baker, *supra* note 10, P.2.

the profits of an enterprise of the other Contracting State.[32] It is vital in helping taxpayers worldwide to determine if they will have a taxable presence. It is very important here for jurisdictions to know whether the Resident state or Source state has a right to tax and collect revenue from the income generated by a person carrying out business activities in more than one state.[33] Also, it becomes equally important for the person carrying on business to know where to pay tax and where to file the return.[34]

There are several justifications for applying the permanent establishment concept to the allocation of taxing rights.[35] First, the principle of international justice or fair allocation of tax revenues requires ensuring source-based taxation in a case when the foreign enterprise utilizes the infrastructure and the beneficial economic environment of the source state. The advantageous economic conditions are implemented from the budget of the state; therefore, one can expect the enterprise to contribute to these costs.[36] Furthermore, ensuring neutrality between the different forms of secondary establishment is another justification.[37] If a foreign enterprise decides to carry out business in the source state by establishing a subsidiary, then this subsidiary will be a resident taxpayer of the source state and will be exposed to a tax burden that applies to all other resident taxpayers according to the domestic law of that state. Accordingly, allowing the source state to impose a tax on profit which is attributable to a permanent establishment will ensure neutrality between the business undertakings within the host states. It is especially true where the double taxation treaty contains the credit or exemption method to eliminate double taxation. In such cases the income of the permanent establishment is taxed exclusively by the source state, creating complete capital import neutrality.[38]

Furthermore, formulating the concept of permanent establishment as a threshold of business activity, below which the state of residence has exclusive taxing right regarding the business profits can be justified by practical reasons.[39] It entails that the enterprise, whose activity in the source state does not reach that

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[32] *Id.*
[33] *Id.*
[34] Pragna Patel, Essay on International Taxation, Permanent Establishment, p.2 available at http://www.fitindia.org/downloads/Pragna_Patel_2011.pdf last accessed on 05 July 2019.
[35] Reimer, Ekkehart, Permanent Establishment in the OECD Model Tax Convention, In Permanent Establishments, A Domestic Taxation, Bilateral Tax Treaty and OECD Perspective, 6th edition, Kluwer Law International, Netherland, (2018), p. 11.
[36] *Id.*
[37] *Id.*, p. 12.
[38] *Id.*
[39] *Id.*

threshold, is relieved from compliance and administration costs in that state which would be disproportionate to the minor business presence of the enterprise.[40]

In a nutshell, Permanent establishment is a benchmark in determining whether the source state has a jurisdiction to impose a tax on a non-resident company that derived profits in the concerned host state. That means it determines the right of a contracting State to tax the profits of an enterprise of the other contracting State. Thus, a country may not tax the business profits of an enterprise unless that enterprise has a permanent establishment in that State.[41]

2. The Ethiopian Rules on Permanent Establishment in Light of OECD and UN Model Convention

Both OECD and UN Model Conventions have defined permanent establishment as "A fixed place of business through which the business of an enterprise is wholly or partly carried on".[42] From this definition, we can easily understand that three cumulative elements should be fulfilled for the existence of permanent establishment. Though, both OECD and UN Model Conventions failed to define these elements, commentary on article 5 of OECD Model Conventions 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, as well as a degree of permanence concerning the taxpayer.[43]

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.[44] 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 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.[45] The business of the enterprise must be carried on wholly or partly at the fixed place, this means usually that persons who, in one way or

[40] *Id., pp. 12*-13.
[41] OECD Model Convention, Art.7.
[42] See Art.5 (1) of both UN and OECD Model Conventions.
[43] Commentary on OECD Model Convention, *supra* note 7.
[44] *Id.,* paragraph 2.
[45] *Id.,* paragraph 4.

another, are dependent on the enterprise (personnel) conduct the business of the enterprise in the State in which the fixed place is situated.[46]

Furthermore, Article 5(2) of the UN Model Convention, which is the same as the OECD Model Convention, sets forth a non-exhaustive list of concepts which often constitute a permanent establishment in the State in which they are located: The term permanent establishment includes especially: "(a) a place of management, (b) a branch, (c) an office, (d) a factory, (e) a workshop, (f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources." Not only this but article 5(3),5(4),5(5) and 5(6) of both UN and OECD Model Conventions have provided for a list of activities that cannot be deemed to be a permanent establishment, conditions when construction or building project by non-resident constitutes permanent establishment, and agency permanent establishment, respectively.[47]

There are, however, significant differences between the permanent establishment rules under the OECD and UN Model Conventions.[48] The main point of distinction between two models can be summarized as follows; first, both OECD and UN Model Conventions deem a building site or construction or installation project to be a permanent establishment if the site or project continues for a certain period of time. The crucial difference between the two treaties is the length of time for which the concerned activities must continue for the site or project to constitute a permanent establishment. The OECD Model Convention deems a site or project to be a permanent establishment where the non-residents' work lasts for more than 12 months while the UN model treaty only requires a six-months project.[49]

The second difference pertains to service permanent establishment. Under the UN model,[50] a non-resident enterprise that renders services of any kind in the source country for one or more periods aggregating more than six months within any 12 months is deemed to have a permanent establishment in the source country. By the contrast, the OECD model treaty has no provision that allows a source country to treat the long-term provision of services as a permanent establishment and thus bypass the rule denying source countries any right to tax

[46] *Id.,* paragraph 7.
[47] See Art. 5(2)-5(6) of the both OECD and UN Model Conventions.
[48] Economic and Social Council Committee of Experts on International Cooperation in Tax Matters: Definition of Permanent Establishment: Finalized Amendments to Current Commentary on article 5 - Permanent Establishment, (2008), P.6
[49] see Art.5(3) of both the OECD and UN Model Conventions
[50] UN Model Convention, Art.5(3) (b)

business income unless the income is derived through a permanent establishment.[51]

The third difference is related to the delivery of a stock of goods. Accordingly, Under OECD based treaties list of what is deemed *not* to constitute a permanent establishment (often referred to as the list of preparatory and auxiliary activities), *delivery* of a stock of goods is mentioned while it is not mentioned in the UN Model Convention.[52] Therefore a delivery activity might result in a permanent establishment under the OECD Model Convention, without doing so under the UN Model Convention. This difference reflects a view that the presence of a stock of goods for prompt delivery facilitates sales of the product and earning of profit in the host country and represents a continuous connection with the source country, and as such may constitute a permanent establishment and be subject to source country taxation. The fourth difference is related to the insurance business. As far as the insurance business is concerned, under the UN Model Convention, there is a special provision specifying when a permanent establishment is created in the case of an insurance business.[53] But, when we come to the OECD Model Convention, we can't find any provision that addresses issues of the insurance business.

Whatever it may be, the OECD Model Convention shifts more taxing powers to capital-exporting countries.[54] Unlike the OECD Model Convention, the UN Model Convention reserves more for capital importing countries.[55] The United Nations Model Convention represents a compromise between the source principle and the residence principle and gives more weight to the source principle than does the OECD Model Convention.[56] In a similar fashion with the UN and OECD Model Conventions, the Ethiopian income tax proclamation has defined the term permanent establishment so that it would be a benchmark in determining when and how the business profits of the non-resident person are subjected to tax.[57] Though the definition provided for the term permanent establishment under the Ethiopian tax regime is similar to that of the OECD and UN Model Conventions, there are, however, significant differences between the

[51] *Id*
[52] See Art. 5(4) of both the OECD and UN Model Conventions
[53] UN Model Convention, Art. 5 (6)
[54] Donald. R. Whittaker, An Examination of the O.E.C.D. and U.N. Model Tax Treaties: History, Provisions, and Application to U.S. Foreign Policy, *North Carolina Journal of International Law& Commercial Regulation* Vol.8, No. 1, (2016), p. 44.
[55] *Id.*, p.46.
[56] *Id.*
[57] Income Tax Proclamation No.979/2016, Art. 4.

deemed permanent establishment rules under the two Model Conventions and Ethiopian income tax proclamation.

To begin with, similar to that of the UN Model Convention, furnishing of service would constitute a permanent establishment if it continues for a set of certain periods.[58] The UN Model Convention requires more than six months while service permanent establishment has not recognized as a tax base under the OCED Model Convention.[59] When we come to Ethiopia, the existing tax regime has recognized service permanent establishment subject to a certain condition. Accordingly, a non-resident enterprise that furnishes services including consultancy service by a person including through employee or by other personnel engaged by a person for such purpose, in the source country for periods aggregating more than 183 days within any 12 months is deemed to have a permanent establishment in the source country.[60] In this aspect, the Ethiopian tax regime is similar to that of the UN Model Convention than the OECD Model Convention.

Furthermore, in a similar fashion with what is provided under both the OECD and UN Model Conventions, building site or construction or installation project would be considered` a permanent establishment if the site or project continues for a set of period. The crucial difference between the OECD Model Convention and the Ethiopian tax regime is the length of time that activities must continue for the site or project to constitute a permanent establishment. The OECD Model Convention deems a site or project to be a permanent establishment where the non-resident's work lasts for more than 12 months while the UN Model Convention only requires a six-month project.[61] Surprisingly, the Ethiopian tax regime requires 183 days which is quite similar to the UN Model Convention.[62] Like that of the UN model convention, the Ethiopian tax regime favors a shorter period of 183 days for considering the construction site as a permanent establishment. This is important to increase revenue from taxes that are the highest source of finance for Ethiopia.

Another point of distinction between the Ethiopian tax regime and the international tax models (OECD and UN model) is concerned with providing a list of activities that cannot be deemed as a permanent establishment.[63]

[58] *Id.,* Art.4(3).
[59] UN Model Convention, Art. 5(3) (b).
[60] Income Tax Proclamation No.979/2016, Art.4(2)(c).
[61] See Art.5(3) of both the OECD and UN Model Conventions.
[62] Income Tax Proclamation No.979/2016, Art.4(2,c).
[63] See Art. 5(4) of both the OECD and UN Model Conventions.

Accordingly, both the UN and the OECD model Conventions have provided for a list of activities that cannot be deemed as a permanent establishment. But, we do not have any provision that addresses a list of activities that cannot be considered as a permanent establishment in our context.

3. Major Problems Associated with Rules on Permanent Establishment under the Ethiopian Income Tax Law

3.1. Problems in Relation to Taxation of Electronic Commerce

Due to technological advancement, the operation of a business in E-Commerce has been posing challenges to the determination of a permanent establishment for the purposes of taxation. The challenges to taxation of E-Commerce are challenges that are faced by governments globally.[64] Failure to protect the tax base of a country from the challenges arising in E-Commerce will result in an unfair environment in the taxation of resident and nonresident business[65], where non-resident business can avoid income tax due to mismatches that exist between income tax legislation and the operations of a business in E-Commerce. It is apparent that the concept of Permanent establishment was designed in an almost moldable approach that enables it to fit any kind of business reality. If we recognize that one fundamental element of existence for a Permanent establishment is the necessity of a geographical, physical location for the business to operate, it gets extremely difficult to determine where such location is when the business is carried out only by electronic means.[66]

The concept of a permanent establishment was developed in 1927, a pre-digital era where transacting with target markets placed reliance on physical premises.[67] The virtual environment, within which E-Commerce exists, has resulted in E-Commerce business not meeting the requirements for a fixed place of business in the determination of the existence of a permanent establishment in the jurisdiction within which business activities are conducted.[68] Business in E-Commerce, however, provides an environment where a business can operate virtually in any market jurisdiction, from any location in the world which

[64] Jinyan Li, Protecting The Tax Base in the Digital Economy, June 2014,p.27,available at http://www.un.org/esa/ffd/tax/2014TBP/Paper9_Li.pdf, last accessed on 31 March 2020

[65] *Id.,* p.28.

[66] Leonardo F.M. Castro, Problems Involving Permanent Establishments: Overview of Relevant Issues in Today's International Economy*, Global Bus. L. Rev.* Vol .2, No.2, (2012), p. 150.

[67] Visesh Choudhary, Electronic Commerce and Principle of Permanent Establishment Under the International Taxation Law, *International Tax Journal*, Vol.37, No 4, (2011), p 42.

[68] *Id.,* p. 39.

provides challenges to the application of the treaty concept related to a permanent establishment.[69]

So as to minimize the challenges posed regarding income taxation of businesses in E-Commerce, BEPS action plan by G-20 and OECD countries have provided three possible options namely; equalization levy, new nexus rule in the form of a significant economic presence and Withholding tax on certain types of digital transactions for the taxation of E-Commerce.[70] Solutions proposed in addressing tax challenges arising from the taxation of non-resident business can be categorized in the following manner.[71] i)Solutions which seek to preserve existing international tax system with minor changes that are effected to accommodate business in E-Commerce ii) Solutions which argue for a shift in the emphasis from source to a residence-based taxation iii) Solutions which argue that international tax rules are not sustainable in the ecommerce environment due to imbalances created in taxation between taxpayers, with the alternative proposal being that of introducing a consumption based tax or a special tax on transactions conducted over the internet.[72]

The first solution is related to the modification of a permanent establishment to accommodate the taxation of the electronic commerce. Accordingly, moving away from a "fixed place of business" to "a significant digital presence" is the main consideration.[73] OECD has suggested that there should be a possible modification to the permanent establishment principle to include business activities which are conducted digitally.[74] Businesses engaged in digital activities in a country may be deemed to have a taxable presence if a significant digital presence is maintained in the economy of the country in which the business transacts.[75] A significant digital presence would accommodate any business that is engaged in digital activities, where minimal physical elements are required in conducting activities of the business.[76] Experiences of Kenya

[69] Jean Philippe Chetcuti, The Challenges of E-commerce to the Definition of a Permanent Establishment: The OECD's Response, 2002, available at http://www.inter-lawyer.com/lex-e-scripta/articles/e-commerce-pe.htm last accessed on 31 March 2020.

[70] OECD, Additional Guidance on the Attribution of Profits to Permanent Establishments, BEPS action plan7, (2018) available athttps://www.oecd.org/tax/transfer-pricing/additional-guidance-attribution-of-profits-to-permanent-establishments-BEPS-action-7.pdf last accessed on 28 July 2019

[71] Choudhary, *supra* note 67, p.51.

[72] *Id.,* p.52.

[73] Pumla Zondo, E-Commerce and the Taxation in South Africa of Non–Residents, Master's Thesis, University of the Witwatersrand, (2017), P.59.

[74] OECD, Addressing the Tax Challenges of the Digital Economy, (2014),P. 143 available at http://www.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy_9789264218789-en, last accessed on 28 July 2019.

[75] *Id.,* P.144.

[76] *Id.*

can be taken as an example. Changes to the Kenyan Corporate Income Tax Act, which came into force last November 2019, has introduced the significant economic presence (SEP) as a remedy for the taxation of electronic commerce by non-resident companies.[77] According to the norm, SEP will be created when the non-resident companies have provided digital, technical, management, consultancy or professional services to resident person in Kenya.[78] The same is true for India. In 2018, India recognized virtual presence as constituting nexus for the purpose of asserting taxing rights and introduced the concept of Significant Economic Presence (SEP) in its tax laws.[79] Accordingly, SEP is inculcated to section 9 of the Income-Tax Act, 1961 ('ITA') from April 1, 2018.[80]

The other alternative is related to Electronic or virtual permanent establishment.[81] As an alternative to be applied to business in E-Commerce, the concept of a virtual permanent establishment has been suggested involving the modification of the concept of permanent establishment to include a virtual fixed place of business and a virtual agency.[82] The extension of a permanent establishment would include the creation of a permanent establishment in the event of a non-resident business maintaining a website on a server of another enterprise located in a jurisdiction.[83] The experiences of Spain can be taken as an example. The concept of a virtual permanent establishment has been considered in Spain where the application of the concept was tested in the 2012 case involving Dell.[84] In addressing the challenges associated with business operating in the absence of a physical presence or premises in the country where

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[77] Digital Economy Taxation Think Tank, Non-Profit Organization, African Route: Kenya Digital Tax & Nigerian Significant Economic Presence as Nexus for 2020 Digital Economy Taxation,(January 2020), available at https://det3.eu/news/nigerian-significant-economic-presence-route-nexus-for-2020-digital-economy-taxation/#page last accessed on 31 March 2020.

[78] *Id.*

[79] Rishi Kapadia, & Mohit Rakhecha, Digital Tax: Why India's Approach to Taxing Google, Facebook Needs to Align with International Approach,(2019), available at https://www.google.com/amp/s/m.economictimes.com/small-biz/legal/digital-tax-why-indias-approach-to-taxing-google-facebook-needs-to-align-with-international-approach/amp_articleshow/68329809.cms last accessed on 31 March 2020.

[80] Delloite, Taxation of Non-Residents Through a Significant Economic Presence: Widened Scope Under the Indian Income Tax Law, (2018) available at https://www2.deloitte.com/in/en/pages/technology-media-and-telecommunications/articles/significant-economic-presence.html last accessed on 31 March 2020.

[81] Zondo, *supra* note 73, P. 60.

[82] OECD, Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-commerce? Final report, (2005), p.65, available at http://www.oecd.org/ctp/treaties/35869032.pdf last accessed on 31 March 2020.

[83] *Id.,p.* 66.

[84] Gary D. Sprague, Spanish Court Imposes Tax Nexus by Finding a Virtual Permanent Establishment,(2013),available at http://www.bna.com/spanish-court-imposes-n17179871765 last accessed on 31 March 2020.

markets are located, the concept of a virtual permanent establishment has been considered in Spain.[85]

The other option is Characterization of income and imposition of a withholding tax.[86] A possible alternative to address the challenges of E-Commerce on income tax is related to the possibility of expanding withholding taxes to include payments for digital transactions.[87] A suggestion has been made for the imposition of a final withholding tax on payments made by a resident for digital goods and services which have been provided by the non-resident business. The withholding tax would be facilitated by financial institutions involved in paying the non-resident.[88] Experiences of Vietnam can be taken as an example. On 13 June 2019, the National Assembly of Vietnam passed a new tax administration law which will impact many non-resident enterprises selling goods and services into Vietnam via digital and E-Commerce business models.[89] Accordingly, withholding tax to tax income derived from E-Commerce, where payments to foreign enterprise will be subjected to a withholding tax is introduced by the new legislation

The final alternative is introducing an internet specific tax.[90] An introduction of an internet specific tax has been proposed to target E-Commerce transactions.[91] The introduction of an internet specific tax called a bit tax would result in digital data flowing over the internet being taxed.[92]The tax suggested would involve a progressive system of taxation applied, to tax the usage of data by non-resident businesses operating online.[93] The tax rate suggested to be applied for the internet specific tax would be based on the size of the operations conducted through E-Commerce or the turnover of the business.[94]

Coming to the context of Ethiopia, the Ethiopian income tax proclamation is not clear as to whether permanent establishment may be created via E-Commerce or not, and how the taxation of business profits that are attributed to E-Commerce ought to be regulated. Despite slight differences, the way Ethiopian income tax

[85] *Id.*
[86] Zondo, *supra* note 73, p. 62.
[87] Li, *supra* note 64, p. 446.
[88] OECD, *supra* note 74, p. 146.
[89] KPMG, Taxation of E-commerce in Vietnam,(2019) available at https://home.kpmg/us/en/home/insights/2019/07/tnf-vietnam-taxation-e-commerce-transactions-remote-digital-sales.html last accessed on 31 March 2020.
[90] Zondo, supra note 73, p. 62.
[91] Choudhary, *supra* note 67, p 53.
[92] *Id.*
[93] OECD, *supra* note 74, p. 147.
[94] *Id.*

proclamation defined permanent establishment is similar to that of the OECD and UN Model Conventions.[95] Among the elements of the definition of a permanent establishment, a place of the business test requires some physical existence in the source country. Accordingly, since the website is not a tangible object, it cannot be a place of business. Besides, the concept of "fixed place" in Permanent establishment is difficult to apply in E-Commerce as companies located anywhere can conduct business everywhere.[96] Hence, it is quite difficult to apply the notion of a permanent establishment in the case of E-Commerce.

Not only this but also the VAT proclamation of Ethiopia can be mentioned to justify the assertion that E-Commerce is not covered within the ambits of permanent establishment. Accordingly, the VAT Proclamation of Ethiopia provides that "*the supply of goods and rendering of services is taxable if it is carried out by a non-resident through a permanent establishment in Ethiopia or through the internet*".[97] From this article, we can easily understand that the supply of goods and services by the non-resident enterprises is subject to VAT provided that the concerned activity is undertaken either in the form of Permanent establishment or *the internet*. Accordingly, had the concept of permanent establishment been extended to E-Commerce, providing *the internet* as an alternative requirement for imposing VAT on the supply of goods and services by non-resident enterprises would not have been necessary. Hence, one can confidently argue that the definition of permanent establishment as envisaged under the income tax proclamation of Ethiopia did not extend to E-Commerce. Since the traditional concepts contained in the definition of a permanent establishment are inadequate to deal with the ever-increasing growth of E-Commerce in the digital era; the rules governing the taxation of E-Commerce should be added under Article 4 of the Federal Income Tax Proclamation No.979/2016. Prominently, I opt for the significance of economic presence (SEP) for the taxation of electronic commerce for Ethiopia.

3.2. Problems in Relation to Artificial Avoidance of Permanent Establishment Status

It is complex to speak about 'artificial avoidance', as what may be avoidance for one country may not be the same for another that interprets the PE principle

[95] See Art.4 (1) of the Income Tax Proclamation No.979/2016, and Art.5 (1) of both the UN and OECD Model Conventions.

[96] Rifat A., E-Commerce Taxation and Cyberspace Law: The Integrative Adaptation Model, *Virginia Journal of Law &Technology*, Vol. 12, No. 5, (2007), P. 9.

[97] Value Added Tax Proclamation of Ethiopia, Proclamation. No. 285/2002, *Federal Negarit Gazetta,* 8th year, No. 33, (2002), Art. 4(7).

in a different form.[98] This is obvious, for instance, with the Dell cases in Norway and Spain: whereas a typical commissionaire structure withstood the exam of the Norwegian Supreme Court, which ruled that there was no PE in such a situation, the same agreement was regarded as a PE in Spain.[99] As an international organization that works on tax, OECD does not elaborate much on what they mean exactly by artificial. Although the term artificial is given no specific definition in the Final Report on Action 7, the report elaborates on the different ways of avoiding PE status it wishes to address with its proposals.[100] In this situation, understanding the current problems of the PE ,and, therefore, defining what artificial avoidance of PEs is calls for a reference to the historical evolution of the concept since, without this historical perspective, it is not easy to fully comprehend the present problems of that institution.[101] The term artificial avoidance is first heard during the famous ruling by the European Court of Justice in the Cadbury Schweppes case.[102] Although this case primarily dealt with the application of controlled foreign corporation (CFC) legislation, the Court defined a wholly artificial arrangement as a fictitious establishment, not carrying out any genuine economic activity.[103]

Various multinational corporations have been and still are using the loopholes that are left in relation to the definition of permanent establishment to artificially avoid permanent establishment status so that their income would be exempted from taxes in source countries. Artificial avoidance of PE status through commissionaire arrangements and similar strategies, specific activity exemptions and splitting up of contracts concerning construction or building project and service permanent establishment are the prominent strategies by which multinational corporations have been using to artificially avoid permanent establishment status.[104]

[98] Adolfo Martín Jiménez, Preventing the Artificial Avoidance of PE Status, a Preliminary Documents Circulated at the United Nations Workshop on "Tax Base Protection for Developing Countries" (Paris, France 23 September 2014), p.13.
[99] *Id.*
[100] Gustav Einar, Dependent Agents After BEPS Especially with Regard to Commissionaire Arrangements, Master's thesis, Uppsala University, (2017), p. 22.
[101] Jiménez, *supra* note 98, p.13.
[102] Arthur Pleijsier, the Artificial Avoidance of Permanent Establishment Status: A Reaction to the BEPS Action 7 Final Report, *International Transfer Pricing Journal*, **(**2016), p. 443.
[103] *Id.*
[104] 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, 2019).

Coming to the context of Ethiopia, artificial avoidance of permanent status is not adequately regulated. One of the rooms for artificial avoidance of the status of PE under Ethiopian tax law is related to commissionaire arrangement in relation to dependent agent. Article 4 (4) of the Income Tax Proclamation provides that when a person, other than an agent of independent status acting in the ordinary course of business, acts on behalf of another person (referred to as the principal) regularly negotiates the contracts on behalf of 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.[105] This can be taken as a good step as the negotiation of contract on the behalf of the principal would give rise to PE.

One of the gaps that MNEs have been using for artificial avoidance of PE status was the fact that negotiation of contracts on behalf of the principal would never give rise to PE as the conclusion of contract on the behalf of the principal was mandatory. Inculcation of negotiation of contract on behalf of the principal as a condition for the creation of PE was the remedy employed by the OECD Model Convention and Multilateral Instrument.[106] Hence, both conclusion and negotiation of contracts on behalf of the principal would give rise to PE. Coming back to the Ethiopian context, though inculcating negotiation of contracts on behalf of the principal as a condition for the creation of a PE is a good start, exclusion of the conclusion of contracts on behalf of the principal from the same article would inevitably lead to artificial avoidance of PE status. The dependent agent might go beyond negotiation and conclude contracts on behalf of the principal. Hence, had the Ethiopian income tax proclamation expanded the scope of the dependent agent by inculcating both conclusion and negotiation of contracts on behalf of the principal as a condition for the creation of PE, it would have given more sense.

Another strategy for artificial avoidance of permanent establishment status is splitting up of contract. Article 4(3) of the Income tax proclamation has provided about construction or building PE. Accordingly, "A building site, or a construction, assembly, or installation project, or supervisory activities connected with such site or project shall be PE only when the site or project or activities continue for more than one hundred eighty-three days."[107] If the building or construction project lasted less than 183 days, it does not create a PE irrespective of whether it is undertaken by related enterprises or not. The same holds for the furnishing of services. If the furnishing of services lasts less than

[105] Income Tax Proclamation No.979/2016, Art. 4(4).
[106] See OECD Model Convention of 2017, Art.5 (5) and Multilateral Convention, Art.12.
[107] Income Tax Proclamation No.979/2016, Art.4(3).

183 days, it does not create a PE irrespective of whether it is undertaken by related enterprises or not.[108] It seems that MNEs may divide their contracts into several parts, each covering a period less than 183 days and attribute it to a different company, of the same group, thereby avoid the formation of PE.

However, the councils of the minister's income tax regulation no 410/2017 have provided the remedy for fighting artificial avoidance status concerning construction or building site.[109] 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 that spent on any connected activities conducted by a related person. The same is true for service PE.[110] Yet, failure of Ethiopian income tax proclaimation to clarify as to what constitutes connected activity or project could be a stumbling block for the implementation of the aforementioned article, and then open the room for artificial avoidance of PE status.

Another avenue by which the non-resident person has been and is still avoiding PE status is based on the specific activity exemption. The repealed income tax proclamation of Ethiopia has a list of activities that do not constitute a PE.[111] Providing a list of activities that do not constitute PE has tended to open the room for artificial avoidance of PE status through specific activity exemption. The new income tax proclamation has avoided a list of activities that do not constitute a PE. This could be taken as the positive aspects of the Ethiopian income tax proclamation as it closes the door or the room that enables the MNEs to artificially avoid a PE status through specific activity exemption.

Despite its tremendous role in fighting artificial avoidance of PE status, avoiding list of activities that do not constitute PE is not advisable. 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".[112] The rationale of the activity exemptions is that these activities are remote from the core, income-generating business activity, therefore they do not exceed the threshold which would justify the taxing right

[108] Income Tax Proclamation No.979/2016, Art. 4 (2) (c).
[109] Income Tax Regulation No.410/2017, Art. 4.
[110] Income Tax Regulation No.410/2017, Art. 4(1).
[111] Income Tax Proclamation No.286/2002, Art.2 (9) (b).
[112] 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, Master's thesis, Uppsala University, (2018), p.15.

of the source state.[113] Hence, imposing taxes on preparatory or auxiliary activities that are not yet the normal business operation would tend to defeat the principal purpose of taxation and the motive of Ethiopia to attract foreign direct investment. In short, the tax should be imposed on an income accrued to our territory, and imposing taxes on an enterprise that has not yet acquired any income is quite paradoxical as it may hinder the free flows of international trade. Hence, it is imperative to provide for specific activity exemption by adopting anti-fragmentation rules.

3.3. Problems in Relation to Place of Management and Effective Place of Management

As provided under article 4(2) (a) of proclamation number 979/16, "*place of management*" is one element to determine whether the non-resident enterprise has a permanent establishment status or not.[114] At the same time, article 5(5) (b) of the same proclamation provides an "*effective place of management*" as a requirement in determining whether a certain body is resident or not.[115] Here, it is difficult to put a line of demarcation between the place of management and effective place of management. The term effective place of management is quite a controversial term that has been attracting the attention of the world communities. To mention some, South Africa is one of the countries where the interpretation of the term "effective place of management" is problematic. South Africa's Income Tax Act No. 58 of 1962 uses the terminology 'place of effective management' when determining the residency of companies. This term is not, however, defined in the said legislation and there is no South African case law specifically dealing with this matter.[116] Again, India is another country where the issue of effective place of management is problematic. Yet, India has introduced a mechanism for determining whether the given place is an effective place of management or not. If we look at experiences of India on this concern, the place of senior management and key management personnel's, place of

[113] Balazs Karolyi, The Challenges of Permanent Establishment Concept and the Response of BEPS Actions, Master's thesis, Tilburg University, (2017), p. 41.
[114] Income Tax Proclamation No.979/2016, Art, 4(2) (a).
[115] *Id.,* Art, 5(5) (b).
[116] Nirupa Padia & Warren Maroun, Determining the Residency of Companies: Difficulties in Interpreting 'Place of Effective Management', *Journal of Economic and Financial Science*, Vol.5, No 1, (2012), p.119

board of directors meeting and shareholders influence are taken as primary factors for determining effective place of management.[117]

The OECD Model Convention does not define the term 'place of effective management'. However, guidance is provided in the commentary on article 4 concerning the definition of a resident (OECD, 2000b) which states that:

> The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the enterprise's business are in substance made. The place of effective management will ordinarily be where the most senior person or group of persons (for example, a board of directors) makes its decisions, the place where the actions to be taken by the enterprise as a whole are determined; however, no definitive rule can be given and all relevant facts and circumstances must be examined to determine the place of effective management. An enterprise may have more than one place of management, but it can have only one place of effective management at any one time.[118]

A discussion paper entitled "the impact of the communications revolution on the 'place of effective management' as a tie-breaker rule" offers additional insights into the meaning of 'place of effective management' by suggesting that the place where the board of directors' meetings are held ,the strategic decisions are taken, the managers' and directors' offices are located, relevant legal documents are kept, and where essential acts in the life of a company are conducted should be considered in determining whether the place is really effective place of management or not.[119]

Furthermore, the UN Model Convention provides that the place where a company is actually managed and controlled, the decision-making at the highest level on the important policies essential for the management of the company takes place, the place that plays a leading part in the management of a company from an economic and functional point of view and the place where the most important accounting books are kept should be considered in determining whether the place is really effective place of management or not.[120] Owing to the aforementioned facts, unless the Ethiopian income tax proclamation clarifies

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[117] Delloite, Place of Effective Management Recommendations on Guidelines to be Issued, (September 2015), p. 4 available at https://www2.deloitte.com/content/dam/Deloitte/in/Documents/tax/in-tax-place-of-effective-management-noexp.pdf last accessed on 31 March 2020.

[118] see Commentary on Art.4 of OECD Model Convention

[119] Burgstaller, E. & Haslinger, K, Place of Effective Management as a Tie-Breaker-Rule Concept: Development and Prospects. *International Tax Review*, Vol.32, No.8, (2004), pp. 376-387.

[120] United Nations (UN) Department of Economic and Social Affairs (DESA), United Nations Model Double Taxation Convention Between Developed and Developing Countries,(2012), p. 94 available http://www.un.org/en/development/desa/publications/double-taxation-convention.htmllast accessed on 31 March 2020.

the term "effective place of management", it might create controversy in determining whether a foreign enterprise is a permanent establishment or resident enterprise.

3.4. Problems in Relation to Interruption of Activity Via Force Majeure

In the case of construction or building sites and service permanent establishment, the use of a period as a yardstick can result in difficult negotiations with foreign authorities. The notion of Permanent establishment has been and still leads to different interpretations among countries and subsequently continues to confuse treaty interpretation.[121] Coming to the context of Ethiopia, the current income tax proclamation no 979/2016 has provided that a building site or construction activities would give rise to permanent establishment only when the site or project or activities continue for more than one hundred eighty-three.[122] What if the project is discontinued due to reasons beyond the non-residents' control within that total period? It may, in such cases, appear as punitive rather than practical. The same holds for service permanent establishment.[123] Accordingly, the determination of when a project commenced as well as non-exclusion of temporary discontinuations due to reasons beyond the control of nonresident may pose various questions. Though seemingly simple, the 183 days period may create difficulties. It has been noted that as there is no provision for temporary absences due to weather, for instance, a Permanent establishment can still arise, leading to unfair taxation standards.[124] While it may be difficult to monitor and enforce this, it would be advisable to have an exception for the one hundred eighty days provision to cover such abnormal circumstances, such as involuntary interruption of construction work due to floods, earthquakes, currency or monetary crisis, strikes and others. Hence, had the Ethiopian income tax law integrated the rules on the interruption of activities via force majeure, it would have given more sense.

[121] Castro, *supra* note 66, p .136.
[122] Income Tax Proclamation No.979/2016, Art.4 (3).
[123] Income Tax Proclamation No.979/2016, Art.4 (2) (C). The furnishing of services is considered as permanent establishment when activities of that nature continue for the same or a connected project for a period aggregating more than one hundred eighty-three days in one year. Here the silence of Ethiopian income tax proclamation as to when the project is said to be commenced, and what ought to be done to the period of 183 days when the project is discontinued by force majeure is quite cumbersome.
[124] See Kelleher, *supra* note 4, p.3.

3.5. Problems in Relation to the Elements of the Definition of Permanent Establishment

As it has been discussed, article 4 of new income tax proclamation has defined permanent establishment as "a fixed place of business through which the business of an enterprise is wholly or partly carried on''.[125] Though the Ethiopian income tax proclamation defined permanent establishment, it does not define the elements of the definition. That means, it does not define 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 a given activity by non-residents would give rise to the creation of permanent establishment or not.
In fact, the law should not be expected to provide a detailed explanation on each and every word that it has used since Legal provisions are needed to be crafted in an economical way. Yet, due to the complexities of the elements of the definition, the world communities have been facing challenges in implementing the rules on the permanent establishment. That is why the OECD Model Convention clarified the elements of the definition of permanent establishment through commentary.[126] Accordingly, fixed refers to a link between the place of business and a specific geographic point, as well as a degree of permanence concerning the taxpayer.[127] 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.[128] The business of the enterprise is said to be conducted through fixed place in a case when a persons who, in one way or another, are dependent on the enterprise (personnel) conduct the business of the enterprise in the State in which the fixed place is situated.[129] Nothing makes Ethiopia an exception. Hence, the existing tax regime should incorporate the definition for some controversial terms like fixed, place of business, and the condition under which certain business activities are said to be undertaken through a place of business.

Concluding Remarks

A permanent establishment is a connecting factor in determining whether the hosting country has the power to impose taxes on non-resident companies that engage in business activities within their territory or not. The concept of a

[125] Income Tax Proclamation No.979/2016, Art. 4(1).
[126] Commentary on OECD Model Convention, paragraph 2 to Art.7.
[127] Commentary on OECD Model Convention, supra note 7.
[128] *Id.,* paragraph 2.
[129] *Id.,* paragraph 7

permanent establishment was developed in 1927, a pre-digital era where transacting with target markets placed reliance on physical premises. The virtual environment, within which E-Commerce exists, has resulted in E-Commerce business not meeting the requirements for a fixed place of business in the determination of the existence of a permanent establishment in the jurisdiction within which business activities are conducted. To this effect, as E-Commerce has sparked considerable debate over the continued viability of the PE rules, numerous reform suggestions have appeared in the tax policy and law literature. BEPS action plan of G-20 and OECD countries have provided three options, namely: equalization levy, new nexus rule in the form of a significant economic presence, and withholding tax on certain types of digital transactions for the taxation of E-Commerce. Various countries have taken unilateral measures to ensure the taxation of electronic commerce via inculcation of significant economic presence, the permanent establishment without a fixed place of business, to their domestic tax legislation. India, Israel and the European Union can be taken as an example. Not only has this but also Kenya and Vietnam introduced a withholding tax system for the taxation of electronic commerce.

Similar to that of the UN and OECD Model Conventions, the Ethiopian income tax proclamation has defined permanent establishment as a fixed place of business through which the business of a person is wholly or partially carried on. Yet, it has various problems. Complete absence of rules on permanent establishment in relation to E-Commerce is the main problem of the Ethiopian tax system. Besides, its failures to define elements of the permanent establishment, absence of clarification in relation to the place of management and effective place of management that are provided as requirements for determining permanent establishment, and conditions for determining whether a certain body is resident or not, respectively, absence of exception for interruption of activities via force majeure in relation to construction or building service permanent establishment, and its failures to manage the currently overwhelming controversies in relation to artificial avoidance of permanent establishment status are also among the major problems of the Ethiopian tax system in relation to the permanent establishment.

Based on the aforementioned conclusion, my recommendation comprised of the followings:

Though Ethiopian income tax proclamation has defined permanent establishment as a fixed place of business through which business of person is wholly or partially carried on, 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. Hence, the Ethiopian income tax proclamation should incorporate the definition for the aforementioned controversial elements of permanent establishment.

The issues of "*place of management''* under 4(2) (a) of proclamation number 979/16, and "*effective place of management''* under article 5(5) (b) of the same proclamation should be clarified as it creates controversy in determining whether a foreign enterprise is resident enterprise or just operating through a permanent establishment. The author recommends adopting the following parameters as a primary factor for determining the effective place of management: the place where the most senior person or group of persons (for example, a board of directors) make decisions; the place where the actions to be taken by the enterprise as a whole are determined; and place of board of directors meeting.

Business activities that are treated as exceptions to the general definition of the Permanent Establishment as laid down under Article 5 (4) of the OECD and UN Model Conventions should be included under Article 4 of the same Proclamation by introducing anti-fragmentation rule which enables tackling artificial avoidance of permanent establishment status.

The Ethiopian income tax proclamation should be amended and include remedies for artificial avoidance of permanent establishment status, and exception for interruption of activities via force majeure concerning construction or building service permanent establishment. In relation to artificial avoidance, sub (a) of article 4(4) of new income tax proclamation should be replaced with "regularly concludes or negotiates contracts on behalf of the principal", and the term "related person or enterprise or connected project or site" should be defined in relation to service and construction or building permanent establishment.

The Ethiopian income tax proclamation should be amended and incorporate rules governing the taxation of E-Commerce. Accordingly, the author recommends applying the significant economic presence criterion (permanent establishment without a fixed place of a business) for taxing electronic commerce. To this effect, the following provision should be added to article 4 of the new Ethiopian income tax proclamation of Ethiopia as sub article 6.

1) Notwithstanding with what is provided under sub article1 and 2, the non-resident person that engage in the electronic transaction is deemed to have

a permanent establishment, when it has a significant economic presence in Ethiopia.

2. Significant economic presence shall mean:

   (a) transaction in respect of any goods, services or property carried out by a non-resident in Ethiopia including the provision of download of data or software in Ethiopia, if the aggregate of payments arising from such transactions during the previous year exceeds prescribed amount; or.

   (b) Systematic and continuous soliciting of business activities or engaging in interaction with a prescribed number of users, in Ethiopia through digital means: Whether or not Agreement for such transactions or activities is entered in Ethiopia; or the non-resident has a residence or place of business in Ethiopia; or the non-resident renders services in Ethiopia.