



**EXISTENCE OF A PERMANENT ESTABLISHMENT AND  
THE ERA OF COVID-19**

- *Q: How can the challenges in identification of home office and agency PE be tackled in the era of COVID 19?*

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## **PREFACE & ACKNOWLEDGMENTS**

After completing my previous education in international business administration and law I decided to pursue this course at Tilburg University in International Business Tax Laws as it clearly reflects my interest in the said area. After going through a lot of hardships and tough decisions I decided to pursue this course after working for two years in a law firm. It was during this course that I had an opportunity to explore and learn more on the different concepts of international taxation and its impact on businesses. Further, it came to my knowledge the ever-increasing importance of Double Tax Conventions (DTC) in the field of international tax law and their vital role in elimination of juridical double taxation and double non-taxation. As this topic has caught my attention, the subject of this thesis is associated with one of the factors of the law of DTCs, i.e. challenges in identification and existence of a Permanent Establishment (PE).

I would like to thank everyone from the bottom of my heart who have supported me in this journey, especially, my friend, my idol, my guru, my mentor, my aunt Mrs. Archana Rathi for her immense support and guidance in the most difficult paths of my life. My parents Rekha and Rajendra and sister Rahi for the constant support all the way back from home. My girlfriend Isha, for standing by me always and for the immense mental and emotional support. I would also like to thank Tilburg University and all my professors at Fiscal Institute Tilburg, Law School for sharing their vast knowledge and experience in the field of international tax law and shaping our future for the bigger challenges in life. From early morning lectures to online classes, everyone at Tilburg University rapidly adapted to the changes and faced the challenges in the best possible way. Last but not the least, all my friends and family back home and my new friends in Tilburg from all over the world who are no less than a family today. I would also like to congratulate my fellow colleagues and friends at Tilburg university for graduating from this unique batch of 2019-2020 and surviving the unfortunate situation of pandemic that the world is facing today. We all have come a long way and the future definitely holds a lot more for us. So, hang in there and I wish you all the best for your future prospects.

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## **ABSTRACT**

In any given country, Permanent Establishment is governed by the relevant domestic PE laws or the double tax avoidance treaties. As a result, some tests are generally used by tax authorities to determine whether a Permanent Establishment exists due to the activities of a foreign enterprise. These different tests and clarifications have been analysed at length in this master's thesis. Permanent Establishment marks the important aspect of source taxation and allocates taxing rights to jurisdictions where income is generated. Such profits which are generated within the territory of that state are attributable to the permanent establishment situated therein. But, to attribute profits to a permanent establishment it is first vital to establish one in a given jurisdiction. Identification and existence of a permanent establishment has become even more challenging in today's times where all the countries have suffered mentally as well as economically because of COVID19. Various travel measures had to be implemented to curb this menace of a pandemic. These measures have consequently affected certain tax issues and concept such as existence of a permanent establishment. Hence, the research question of this thesis is to identify the existence of a permanent establishment in a normal situation i.e. without the travel restrictions imposed by the governments in regard to COVID19 as against identifying the existence of a permanent establishment in between the crisis of a pandemic. It will be interesting to see how this situation will turn out for businesses and tax authorities as regard to taxation of permanent establishment.

## ABBREVIATIONS

BEPS	Base Erosion and Profit Shifting
DTC	Double Tax Convention
MAP	Mutual Agreement Procedure
MLI	Multilateral Instrument
MNCs	Multinational Corporations
OECD	Organisation for Economic Cooperation and Development
OECD MC	OECD Model convention
PE	Permanent Establishment
RBI	Reserve Bank of India
SC	Supreme Court
UAE	United Arab Emirates
UK	United Kingdom
UN	United Nations
UN MC	UN Model Convention
US	United States

## PREFACE & ACKNOWLEDGMENTS

## ABSTRACT

## ABBREVIATIONS

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## **1. INTRODUCTION & MOTIVATION OF THE STUDY**

In any given country, Permanent Establishment (hereinafter: PE) is governed by the relevant domestic PE laws or the double tax avoidance treaties. Though a Permanent Establishment is defined and explained in various primary and secondary laws, the determination of such Permanent Establishments is notoriously problematic or disputable in many cases. As a result, some tests are generally used by tax authorities to determine whether a Permanent Establishment exists due to the activities of a foreign enterprise. Undoubtedly the tests and scrutinization of such activities will defer country by country. Thus, it will be interesting to read more on different aspects related to a Permanent Establishment and the challenges regarding the identification of the same.

In case of double tax treaties, the model tax conventions of the United Nations (hereafter: UN) and the Organisation for Economic Co-operation and Development (hereafter: OECD) are most relevant. This thesis will mainly focus on the OECD Model tax convention (hereafter: OECD MC) for many reasons. Though the OECD guidelines are a soft law, majority of the bilateral Double Tax Conventions (hereafter: DTC) are settled on the approach of the OECD MC. Further the Base Erosion and Profit Shifting (hereafter: BEPS) actions in regard to permanent establishment are also an important part of this research and study. In the further chapters the author also highlights the important differences/similarities in the UN and OECD approach as regard to the concept of permanent establishment and the criteria for the identification of the same.

In the 19<sup>th</sup> century the theory of PE first came into existence as the development of the legislation created by German domestic<sup>1</sup>. This was the epoch when the business movement was growing and the way businesses and resources were changing<sup>2</sup>. Hence to avoid double taxation on businesses functioning in the various municipalities of Prussia, the theory of PE was established<sup>3</sup>.

The key aim of the PE is to regulate the right of a contracting state to tax the income of a company of the other state. As an outcome of this, administration or application of the suitable and correct tax policy holds a crucial role. The income that is generated in these developing countries needs to be appropriately allocated to them for apparent reasons for development and growth<sup>4</sup>. This revenue generated is often

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<sup>1</sup> Atanasov, A. (2017). Permanent Establishment 2.0 - Is It Time for an Update? *SSRN Electronic Journal*.

<sup>2</sup> Hoffart, B. (2007). Permanent Establishment in the Digital Age: Improving and Stimulating Debate Through an Access to Markets Proxy Approach. *Northwestern Journal of Technology and Intellectual Property*, [online] 6(1), p.106. Available at: <https://scholarlycommons.law.northwestern.edu/njtip/vol6/iss1/6/> [Accessed 1 Apr. 2020].

<sup>3</sup> Atanasov, A. (2017). Permanent Establishment 2.0 - Is It Time for an Update? *SSRN Electronic Journal*.

<sup>4</sup> Steenkamp, L.-A. (2014). The Permanent Establishment Concept in Double Tax Agreements Between Developed and Developing Countries: Canada/South Africa As A Case in Point. *International Business & Economics Research Journal (IBER)*, 13(3), p.539.

substantial and vital as it supports a country's economy and help them in improving poor citizen's standards of living<sup>5</sup>.

The upcoming and growing countries in this age of development have turned to and adopted the double tax agreements to entice the foreign direct investment<sup>6</sup>. Also, the developing countries, especially, should consciously take into consideration the pattern of their tax treaties in order to restraint counter tax smoothly, without having to lose the foreign direct investment<sup>7</sup>. OECD published the report in the year 2015 as a fragment of the final BEPS package on Preventing the Artificial Avoidance of Permanent Establishment Status. This report suggested changes in the definition of the PE in the Article 5 of the OECD MC. This change was vital in defining whether the income tax should be paid by the non-resident enterprise in another state<sup>8</sup>.

As defined in paragraph 1 of Article 5 of the OECD MC, Permanent Establishment stands for a, "A fixed place of business through which the business of an enterprise is wholly or partly carried on"<sup>9</sup>. The theory of PE stated by OECD asserts that PE plays a crucial role in the clarification and application of the double tax agreements. As this theory defines a nation's rights to tax the business activities of a foreign company within that country<sup>10</sup>.

An existence of a permanent establishment justifies the taxing right of a jurisdiction. Hence, it is crucial to identify the existence of a permanent establishment in any jurisdiction for companies and individuals to contribute a fair share of their profits and thereby justify taxation by the source state. The author of this thesis intends to discuss and analyze how to identify the existence of a PE in a jurisdiction and what are the challenges faced. Also, it is pertinent to note how the COVID19 pandemic is affecting countries and businesses worldwide. The governments across the globe are forced to make some mandatory restrictions and travel bans across the world in order to overcome this pandemic. In this situation an employee who is working in a cross-border situation and has to travel in another jurisdiction to perform

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<sup>5</sup> Steenkamp, L.-A. (2014). The Permanent Establishment Concept in Double Tax Agreements Between Developed and Developing Countries: Canada/South Africa As A Case in Point. *International Business & Economics Research Journal (IBER)*, 13(3), p.539.

<sup>6</sup> Steenkamp, L.-A. (2014). The Permanent Establishment Concept in Double Tax Agreements Between Developed and Developing Countries: Canada/South Africa As A Case in Point. *International Business & Economics Research Journal (IBER)*, 13(3), p.539.

<sup>7</sup> Steenkamp, L.-A. (2014). The Permanent Establishment Concept in Double Tax Agreements Between Developed and Developing Countries: Canada/South Africa As A Case in Point. *International Business & Economics Research Journal (IBER)*, 13(3), p.539.

<sup>8</sup> www.oecd.org. (n.d.). *OECD releases additional guidance on the attribution of profits to a permanent establishment under BEPS Action 7 - OECD*. [online] Available at: <https://www.oecd.org/tax/oecd-releases-additional-guidance-on-the-attribution-of-profits-to-a-permanent-establishment-under-beps-action7.htm> [Accessed 1 Apr. 2020].

<sup>9</sup> Nyanin, G. (2019). *Review of the definition of permanent establishment*. [online] Lexology.com. Available at: <https://www.lexology.com/library/detail.aspx?g=3b688f7c-9116-4e8c-bfb1-6c8c9aafb03> [Accessed 1 Apr. 2020].

<sup>10</sup> Van Schalkwyk, L. and Van Schaik, R. (2012). A critical analysis of the concepts 'Permanent Establishment' and 'Foreign Business Establishment.' *Journal of Economic and Financial Sciences*, 5(1), pp.63–82.

his duties physically, cannot do so. Thus, employees of companies are forced to work from the place they are residing, even if they are not permanent residents of that country. Such a working condition might give rise to different tax obligations and existence of a PE in that jurisdiction. Thus, the author of this thesis intends to study and compare the two different situations to identify an existence of a PE in a given jurisdiction. What are the challenges faced and how to identify a PE in a normal situation as against how can the risks of creating a PE be tackled in the time of a pandemic as regard to the restrictions imposed by the governments?

## **1.1 RESEARCH QUESTIONS AND STRUCTURE OF THE THESIS**

‘Permanent Establishment’ is a term used internationally to indicate a foreign taxable business presence in a particular jurisdiction. The criteria for identifying a PE can be elusive in all forms of business, and so is the criteria for attributing profits to the same. The work of international bodies such as the OECD and the UN are tremendous regarding permanent establishment. The OECD and UN model conventions are predominantly used models in this respect. A lot of changes have been made over the years, considering all the different forms of businesses and taxation rights of different countries. It is thus crucial from the perspective of the author to study the different challenges and understand how to conclude if a PE exists in a given jurisdiction. It is also very unfortunate that the world today is facing a terrible pandemic which has affected all countries and businesses in every manner. As mankind is tackling this situation with all the efforts, it is pertinent to note that many of the businesses have changed their working pattern as traveling in such a situation becomes impossible as well as fatal. As a result, it will be interesting to see how this situation has affected this particular topic of Permanent Establishment. Thus, this thesis forms its basis on the following research and sub-research question;

- *How can the challenges in identification of home office and agency PE be tackled in the era of COVID 19?* With this research question, the author intends to study and analyse how can the changing business conditions as a result of a pandemic, trigger the risk of PE in a given jurisdiction. The concept of Home office (working from home) is widely being used these days as a result of the travel restrictions. Does this give rise to a PE in that jurisdiction? Similarly, the place from where a person is concluding contracts for a non-resident enterprise, where he is stranded because of travel restrictions, does this trigger an agency PE in that jurisdiction? This being the main focus of this thesis will be further discussed and analysed with the help of the following sub-research questions.
- *What are the principles for allocating tax jurisdiction?* With this sub research question the author highlights the principles incorporated by countries to allocate tax jurisdictions. The importance of the Source principle that justifies the concept of a permanent establishment and

allocation of tax jurisdiction to the source state. In chapter 2 this is discussed at length along with understanding the purpose and rationale of a Permanent Establishment.

- *What are the types of Permanent Establishment?* The different types of PE are discussed in chapter 3 with the help of this sub research question, with the focus of analysing the existence of a fixed place PE and agency PE.
- *What are the challenges in identification of a Permanent Establishment in normal situation?* This sub research question intends to analyse the challenges in identification of a PE in the normal situations i.e. without the travel restrictions and the pandemic measures applied by the governments of different countries.
- *Can the Dispute Resolution Mechanism be effective in solving the disputes arising by the potential PE risks triggered by the pandemic?* The Mutual Agreement Procedure (MAP) is discussed in chapter 5, so as to understand if this mechanism is effective in settling disputes between countries that are arising due to the potential PE risks which are triggered as a result of government restrictions and travel ban. With this chapter the author intends to highlight the MAP and possibly offer one of the solutions to settle the disputes arising in regard to the topic of this thesis.

To attribute profits to a Permanent Establishment, it is of vital importance to decide whether a PE exists in a given jurisdiction. Hence, this thesis mainly focuses on the identification and existence of a Permanent Establishment in a normal situation as against in the era of COVID19. To give an overview, the author analyses the basic concepts of a PE, how does a Permanent Establishment work? What are the criteria to identify the existence of a Permanent Establishment? What are the different types of PE? And What is the impact of the pandemic on the existence of a PE?

Based on the above research questions, [Chapter 2] entails the introductory part and the current international tax framework. It is important to understand the different principles about the allocation of tax jurisdictions. The concept of source principle that justifies taxation of a PE in any jurisdiction. The purpose and rationale of the concept of Permanent Establishment is discussed thereon. Later, the author intends to analyse the concept of Permanent Establishment which leads to the ever-increasing disputes between countries on who gets to tax the piece of the pie (i.e. profits of an organisation)? [Chapter 3] analyses and will eventually guide us through the concept of PE according to the OECD MC, and the different types of PE i.e. Fixed place PE and Agency PE highlighting the relevant/significant changes and developments throughout the past years. This analysis will help in determining the existence of a PE in a normal situation i.e. without any restrictions of the pandemic

imposed by the governments around the globe. [Chapter 4] scrutinizes and compares the current situation of the pandemic as against the normal situations mentioned in chapter 3 which has forced businesses to change the working patterns all over the world. The author intends to analyse this chapter about the different guidelines issued by tax authorities around the globe and mainly in the light of OECD guidelines. A specific comparison of Agency PE and ‘home office’ PE has been put forth by the author based on chapters 3 and 4 as relevant to the research question of this thesis. Despite of all the guidelines, rules and regulations, countries often get into disputes over many topics including identification and existence of a permanent establishment. Hence, in [Chapter 5] the dispute resolution mechanism has been discussed as mentioned by the OECD MC. In this chapter the author intends to study and put forth a possible solution to settle disputes effectively between countries over the issue of existence of a PE in the times of COVID19 with all the restrictions and travel bans imposed all around the world. Since there is no settled principle of law or mention about such situations in any of the tax treaties, there can be a lot of confusion between countries whether to qualify certain types of business activities as a PE. Finally, in [chapter 6] the author then summarizes the important findings regarding the research and the sub-research questions. This thesis takes the basis of OECD MC and its commentaries along with the OECD guidelines published in the light of COVID19 for analysis of the research questions and consequently to conclude.

## **1.2 DELIMITATION**

This thesis focuses on aspects of a Permanent Establishment as pointed out in the above research questions. The research and the analysis specifically aim to focus on problems regarding the identification and existence of a permanent establishment and the recent developments and guidance by OECD and other countries for changes according to the COVID19 measures. Going ahead, the author intends to scrutinize the challenges in the identification of different types of PE, such as Fixed Place PE and Agency PE on the same lines so as to reach a conclusion in regard to the current scenarios in the field of International Taxation. Further, the concept of ‘home office’ has been discussed considering the travel restrictions in all countries. Though different types of PE have been discussed, the aim of this thesis is to compare the home office PE and Agency PE in normal situations i.e. without the travel restrictions as against the existence of a home office PE and Agency PE during the current situation of pandemic. All the other types of Permanent Establishments are mentioned for the purpose of clear analysis but are not entirely in the scope of this thesis. Furthermore, the author of this thesis intends to study and analyse the PE risks for companies, as most of the companies are vulnerable to this situation of pandemic as they have a greater number of employees working for them in cross-border situations. For this study Permanent Establishment for individuals is not within the scope of this thesis.

The author intends to analyse the research question and reach a conclusion accordingly in the light of OECD MC along with the commentary and the guidelines of OECD published in accordance to the COVID19 measures relating to Permanent Establishment. Though the rules of the OECD are not binding on the member countries, most of the countries apply the OECD MC and moreover the BEPS actions specifically target the alteration of OECD MC. Other than the OECD MC the UN MC also exists, which does not differ much from the OECD MC other than the fact that the UN MC focuses on source-based taxation which largely favours the developing countries. The analysis of the research questions is not based on the UN MC as it is out of the scope of this thesis. Also, the impact of Multilateral Instrument (Hereinafter: MLI) on the permanent establishment is not in the scope of this thesis.

The author will be dealing with the basic principles in the light of the OECD MC, its commentaries and guidance on the COVID19 measures along with case laws on identification and existence of a permanent establishment. As a consequence, the part of attribution of profits to a PE is not within the scope of this thesis. The focus of this thesis is to identify the existence and compare how a home office or agency permanent establishment is located in a given jurisdiction in a normal situation i.e. without the restrictions of COVID19 as against the restrictions imposed to curb the menace of pandemic.

### **1.3 METHODOLOGY**

To study and answer the research question of this thesis, the author takes an interdisciplinary approach. Practices and guidelines from other countries are considered which are also in line with the guidelines published by the OECD. Furthermore, the author sets the benchmark i.e. OECD guidelines on the impact of COVID19 crisis to test all other guidelines and approaches. The case laws on identification of existence of a PE from different jurisdictions are considered for the analysis and comparison of this topic. For the above purposes a legal as well as literature approach is adapted by the author. After examining the study in chapters 3 and 4 a comparative analysis is done to reach the conclusion for the main research question of this thesis, where the author highlights the important changes and the impact of COVID19 restrictions on existence of a 'home office' PE or Agency PE in a certain jurisdiction. The author will reach the conclusion taking into consideration all the practical views, interpreting the OECD MC along with its commentary and the relevant case laws.

## **2. INTERNATIONAL TAX FRAMEWORK AND THE CONCEPT OF PERMANENT ESTABLISHMENT**

### **2.1 INTRODUCTION**

In this chapter, the author intends to study and analyse the different principles of international tax framework. In the following paragraphs the Nationality principle, Residence principle, Source principle and the principle of Origin and Destination based principle will be discussed in detail. From the author's point of view and the subject of this thesis, it is vital to understand these principles of income allocation between various jurisdictions. To understand the concept of Source Principle that justifies the taxation of a PE in a jurisdiction, it is also important to study other principles of income allocation. All countries incorporate these principles to formulate the tax treaties which are responsible for allocating income between jurisdictions.

All countries intend to tax the profits of different businesses operating worldwide or within their jurisdiction. This is for obvious reasons of collecting revenue and development of such countries. But it is unfair on the part of the taxpayer if he is subject to tax for the same income in different jurisdictions. This often leads to international juridical or economic double taxation<sup>11</sup>. On the other hand, it is crucial for the states to justify taxation. Without a proper link between the state and the taxpayer, taxation cannot be justified and no tax can be levied. Therefore, whoever is residing in the state, enjoying the benefits thereof, stemming income from that state, shall be liable to taxation. This is well connected with the direct benefit principle. It is, therefore, necessary to understand the principles of Nationality, Residence and Source along with principles of origin and Destination as justifications for taxation of income. These principles being widespread in the international tax law give a broad perspective of how taxation can be levied on different businesses operating in different jurisdictions<sup>12</sup>.

These theories can be derived from the national legislation and in double tax conventions. To establish the link between the taxpayer and the state and for the states to justify taxation usually the nationality principle or the principle of residence or a combination of both is considered to start with. However, when income is derived from operations in any other state, other than the state of residence, this other state intends to tax such income. This phenomenon is linked to the source principle, i.e. from where the source of income is located. As a result, tax laws in different countries are based on different combinations of these principles and not on any one of these<sup>13</sup>. It is pertinent to note that in literature these principles are criticised and two other principles will be analysed as a result. First, the principle of Origin which can be related to a more precise interpretation of the source principle. This principle focuses on the concept of substance over form considering the present transfer pricing regulations. The

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<sup>11</sup> Kemmeren, E. C. C. M. (2001). *Principle of Origin in Tax Conventions: A Rethinking of Models*. Mr. Eric C.C.M. Kemmeren/Pijnenburg vormgevers.uitgevers. pg 12-14.

<sup>12</sup> Romyn, M. (1999). *Internationaal belastingrecht*.

<sup>13</sup> Van Raad 2014, p.18-19.

other is the principle of destination, which more specifically takes into consideration the location of the consumer as against the other principles which focus on the location of the supplier for allocation of the taxing rights. In the following paragraphs these principles are discussed in detail.

### **2.1.1 PRINCIPLE OF NATIONALITY**

An individual's nationality/citizenship is derived from the domestic laws of that relevant country<sup>14</sup>. Previously a person's tax liability was based on his nationality/citizenship<sup>15</sup> and this was also important from the point of view of tax treaties. Thus, this principle is dominant in many countries and is used as a mean to justify tax claims. It is argued in the literature that nationality itself does not produce income and therefore, this principle is insufficient to allocate tax jurisdiction appropriately<sup>16</sup>. For instance, the United States (Hereinafter: US) considers nationality/citizenship as the vital principle to rationalize taxation<sup>17</sup>. In the case of *Cook v/s Tait*, it was stated that:

“The principle was declared that the government, by its very nature, benefits the citizen and his property wherever found, and therefore has the power to make the benefit complete. Or, to express it another way, the basis of the power to tax was not and cannot be made dependent upon the situs of the property in all cases, it being in or out of the United States, was not and cannot be made dependent upon the domicile of the citizen, that being in or out of the United States, but upon his relation as a citizen to the United States and the relation of the latter to him as citizen. The consequence of the relations is that the native citizen who is taxed may have domicile, and the property from which his income is derived may have situs, in a foreign country and the tax be legal-- the government having power to impose the tax<sup>18</sup>.”

Citizenship/Nationality in the US is compared to an insurance policy where the holder enjoys the benefits and the protection wherever needed. This concept therefore, justifies taxation of non-resident citizens by the US of their overall income.

However, the nationality principle cannot be justified as an appropriate and sufficient principle to fairly allocate tax jurisdictions. The reason behind this is that nationality or citizenship in itself cannot produce income or allow possession of wealth<sup>19</sup>. Being a national of a particular jurisdiction does not necessarily mean that the income is earned or produced in the same state or any other state and therefore should not be taxed solely on that basis. A fair allocation of tax jurisdiction should be the one where the subsequent income is produced using the benefits and resources of that state. Thus, nationality, in other words,

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<sup>14</sup> ECCM Kemmeren, 2001, p.27.

<sup>15</sup> Manuel Pires, *International Juridical Double Taxation of Income*, Kluwer Law and Taxation Publishers, 1989, Series on International Taxation, Volume 11, p. 110.

<sup>16</sup> ECCM Kemmeren, 2001.

<sup>17</sup> See Article 1, paragraph 4 United States Model Income Tax Convention, 1996.

<sup>18</sup> *Cook v Tait*, 265 US 47, 56 (1924).

<sup>19</sup> ECCM Kemmeren, 2001, p.28.

shows personal attachment to a particular place and nothing more regarding the allocation of tax jurisdictions<sup>20</sup>. For example, if tax jurisdictions are allocated based on the above-mentioned principle of nationality, let us consider that a person YZ is a national of State A – is a resident of State B - and holds an enterprise in state C. In this case according to the above principle of nationality, YZ would not be taxed in state B or C for the income that is generated in state C. The tax jurisdiction in the above example would only be allocated to state A. Such provision will often lead to disputes between jurisdictions as country B and C would also want to tax the profits of the enterprise in state C, which is well connected to the territory principle, residence principle or the direct benefit principle<sup>21</sup>. Thus, according to Kemmeren, it is not appropriate to allocate tax jurisdiction based on nationality, as the action by the concerned state is not because the income has been produced by the means of that state or through the preservation of wealth, but merely based on nationality. This approach is mainly criticized as it infers a rough amount for all companies, irrespective of the income. When income is considered in this regard it is also relevant to take into consideration its relation with the state. Hence, different principles in this regard can deliver a better results in a fair manner.

### **2.1.2 PRINCIPLE OF RESIDENCE**

The definition of the residency differs among different countries. The residence state is one of the most important aspects of taxation. In OECD MC as well as in the national legislation this is established depending on the facts and circumstances of every case, for instance, the place where most of the management decisions are finalised is appropriate for a company<sup>22</sup>. Different criteria are set out so as to establish if a person or a company is a resident of a particular state. Following these criteria determines the residency of a person or a legal person which then allocates taxing rights to the jurisdiction based on this principle. The important factors to look out for a person are, his physical presence in the jurisdiction. This is one of the important factors in determining the residency of an individual in a given jurisdiction. Equivalent to this can be his owned house, bank accounts and the existence of his family. On the other hand, for companies, it is vital to take in to account the effective place of management which determines the residency of the same. Based on these factors it can be argued that the taxation rights should be allocated to the country of residence since there are some direct benefits and facilities provided by that country to the individuals or companies which eventually support in generating income<sup>23</sup>. Many more practical advantages of this principle can be noted, one of them being that it can be naturally easier as well as convenient for the state of residence to scrutinize, audit

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<sup>20</sup> Manuel Pires, *International Juridical Double Taxation of Income*, Kluwer Law and Taxation Publishers, 1989, Series on International Taxation, Volume 11, p. 120 and p.131-134, where other arguments in favour and against have been analysed by the author.

<sup>21</sup> ECCM Kemmeren, 2001, p. 27-28.

<sup>22</sup> OECD Commentary on Article 4, Paragraph 24.

<sup>23</sup> See E.C.C.M Kemmeren, 2001.

and implement tax obligations on the taxpayer. Though this view has been criticized in the literature, and the author agrees with the view of Kemmeren that the factor of convenience cannot be a prime argument to allocate taxing rights to a given jurisdiction<sup>24</sup>. It is pertinent to note that in recent times it has now become easier to exchange information between states and this can, therefore, solve most of these practical problems in an efficient way<sup>25</sup>.

Taxation by the residence state can go along with the universality principle. Therefore, a resident can be taxed on his worldwide income and the source or origin of that income is not relevant in this regard as it aggregates the overall income of the taxpayer. This makes taxation easier and therefore advantageous considering the redistribution function in this regard<sup>26</sup>. Depending on the respective criteria, residents in the Netherlands<sup>27</sup> and India<sup>28</sup> are taxed on their worldwide income.

Though the residency is one of the most important principles as regard to taxation there are some disadvantages related to this method as well. The residency does not assess where the value has been created and management of a business can easily be separated from the other parts of the business. Further, the market conditions and the actions of businesses in different countries is not addressed in this method. It is important to note that value creation or the place where the wealth has been generated and the place where the wealth is consumed can be different. Residency in itself cannot generate profits and therefore allocation of tax jurisdiction on that basis is not appropriate as this method allocates taxing rights to a place where the wealth has been consumed, rather than focusing on the aspect of value creation<sup>29</sup>. Having discussed these two main principles, the principle of source is discussed in the next paragraph which is vital from the perspective of this thesis.

### **2.1.3 PRINCIPLE OF SOURCE**

The source principle consists of various types of income that is allocated to the source state i.e. where the income is generated. This principle is in contrast to the other two principles mentioned above. As against the nationality and the residence principle, source principle does not intend to tax the worldwide income of the taxpayer, but the income that is generated within the boundary of a given jurisdiction. Commonly states intend to tax the income that has been generated within the country by a non-resident. The justification for allocating taxing rights to the source state is that the income was generated in that state, with or without the resources available therein. Thus, the source state can include various types of income and the way it is generated, for instance, it can be the place where the tangible or intangible

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<sup>24</sup> See E.C.C.M Kemmeren, 2001.

<sup>25</sup> See OECD. (2013). *Action Plan on Base Erosion and Profit Shifting*.

<sup>26</sup> Vanistendael, F. (2012). Is fiscal justice progressing? *Bulletin for International Taxation*, 538. IBFD.

<sup>27</sup> See Article 2.1, paragraph 1, sub 1 Dutch PITA 2001 and article 2 Dutch CITA 1969.

<sup>28</sup> See Section 6 of Indian Income Tax Act, 1961.

<sup>29</sup> See E.C.C.M Kemmeren, 2001. p.32.

property is situated or the place where contracts and agreements are concluded or costs are finalised<sup>30</sup>. According to Kemmeren;

*“a person who receives income from a person or property situated in a state has such a close relation with the state where that person or that property is physically that from this relationship an obligation to support that state is justified.”<sup>31</sup>*

To list the advantages of this principle, it is easier for the tax authorities and administration purposes. This principle focuses more on the place where the income is generated legally. The downside to be noted in this regard is that due to the changing situations and concept of digitalisation as well as globalisation it may no longer match with the economic reality. As a result, the principle of origin as mentioned by Kemmeren is explained in the following paragraph and the author agrees with this view. In the view of the author and the research question of this thesis it is vital to understand these principles of source and origin as these are the principles that justify taxation by the source state or the place from where the income is generated. As regards to the PE concept, the non-resident business i.e. the business which is operating in another country than which it is a resident, that other country (i.e. the source country) settles on not taxing the cross-border profits that are resulting from the said business operations, unless and until the non-resident taxpayer has maintained a Permanent Establishment in that other country. The profits are then attributable to this PE in the source country<sup>32</sup>. In this regard, Article 7 of the OECD MC is also relevant as it denotes the attribution of profits to the other country (source country) where the non-resident business carries on its business activities through a PE situated therein<sup>33</sup>. This concept, therefore, in the opinion of the author allows the source country to tax the profits generated within their territory. This will surely lead to disputes between jurisdictions as everyone wants to tax the piece of the pie and on the other hand justify taxation without burdening the taxpayer with double taxation. Thus, it is of utmost importance to successfully identify if a PE exists in a given jurisdiction. Article 5 of the OECD MC thereby lists certain criteria and threshold in this regard. Once a PE is identified in a given jurisdiction, the second step is to attribute profits to PE. This, however, is out of the scope of this thesis and therefore the author will focus on the topic of identification of PE and the challenges in that regard.

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<sup>30</sup> See E.C.C.M Kemmeren, 2001.

<sup>31</sup> See E.C.C.M Kemmeren, 2001. P.33-34.

<sup>32</sup> Arthur Cockfield, “Reforming the Permanent Establishment Principle Through a Quantitative Economic Presence Test” (2003) 38 Can. Bus. L. J. 400-422.

<sup>33</sup> OECD Model Convention, 2017, Article 7.

#### **2.1.4 PRINCIPLE OF ORIGIN**

The principle of origin and principle of destination are the two concepts that have come up from the need of modification of the current system. Not everyone agrees with the above-mentioned principles and thus it is necessary to discuss these two principles briefly. The principle of origin reflects as a more detailed interpretation of the source principle. It mainly focusses on the concept of 'substance over form'. Where the relationship between the generation of income has been established, this principle allocates taxing rights to that state and therefore justifies taxation by that state where the income is generated. The connection between income and territory of a country is dominating under this principle, which is not found in principle of source<sup>34</sup>. This principle justifies taxation based on all other important principles in international taxation such as direct benefit principle, economic allegiance, faculty principle. Thus, it is the principle which should triumph under any given situation<sup>35</sup>.

For instance, assume an intermediate holding company present in state X. This company receives income from an operating company in state Y. And further, the company in state X passes on this income to the top holding company in state Z. Under this situation depending on the facts and circumstances, normally the taxing rights would be allocated to state X and Y based on the source principle. But, under principle of origin, these taxing rights are only granted to state Y where the actual income is generated.

#### **2.1.5 PRINCIPLE OF DESTINATION**

This principle of destination is different from the all above mentioned principles. All the above principles allocate taxing jurisdictions on the basis of the supply side of businesses. Where on the other hand this principle proposes to allocate taxing jurisdictions on the basis of demand side of the businesses i.e. where its consumers are based. This is another logical interpretation of allocating tax jurisdiction on a fair basis in the author's view. Only relying on the supply side of businesses would underestimate the most important concept in economics of supply and demand. Moreover, looking at the current scenario of the digitalized businesses it justifies more appropriately, allocating tax jurisdictions to such consumer-based jurisdictions. Simply put, the logical interpretation of this principle is based on the explanation that value is created where the demand side of the market is located and therefore if there is no demand, there would be no income<sup>36</sup>.

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<sup>34</sup> See, E.C.C.M Kemmeren, 2001, p. 83.

<sup>35</sup> See, E.C.C.M Kemmeren, 2001, p. 35-37.

<sup>36</sup> Musgrave, *Principles for Dividing the State Corporate Tax Base*, in Charles E. McLure, Jr. (ed.).

## **2.2 PURPOSE AND RATIONALE OF PE CONCEPT**

After analysing the above principles, it is clear that the permanent establishment is one of the important concepts relating to the source principle. A given jurisdiction is able to tax the profits generated within its territory subject to identification of PE therein. Hence, it constitutes one of the most vital justification of the source principle i.e. where the profits have been generated. For profits to be attributable to such a PE, prima facie it is important to identify a PE within that territory. Where it is concluded that there is no existence of a PE, no profits can be attributed and therefore no revenue can be generated for the states where income has been produced.

Therefore, in the author's view it is significant to understand the concept of Permanent Establishment and its types. The following chapters are aimed on this analysis and what changes has the pandemic caused in the concept of Permanent Establishment. This part being the focus of this thesis, the author aims at analysing and comparing the concept of home office PE and agency PE in normal situations as against in the time of a pandemic with government restrictions forcing businesses to adapt new ways of working in cross-border situations.

## **3. IDENTIFICATION OF PERMANENT ESTABLISHMENT**

### **3.1 INTRODUCTION**

In this chapter the author analyses the concept of PE as mentioned in article 5 of the OECD MC, this has been discussed in paragraph 3.2 and 3.3 along with the PE exemptions. In paragraph 3.4 different types of PE have been discussed with focus on Fixed place PE and Agency PE so as to compare them in chapter 4 where the situation is studied in case of current pandemic. It is also pertinent to note that with the different working conditions and with different business ideas, the world is transforming fast with the ever-advancing technology so are businesses. Hence this study will support the analysis in chapter 4 where the concept of 'home office' PE has been discussed. The comparison aims at providing solution in case of such travel restrictions in a pandemic, subject to these working models do not become a new norm or way of life over the period of time.

### **3.2 OECD MODEL ON EXISTENCE OF A PERMANENT ESTABLISHMENT**

As explained from the above chapters, the concept of Permanent Establishment addresses one of the most important aspects of source taxation. A given jurisdiction can tax the profits that are attributable to the PE in that country subject to certain conditions. It is therefore pertinent to understand the concept of PE in detail as mentioned in the OECD MC and the commentary therein. Though OECD guidelines are a soft law and not binding on any of the countries, most of the countries have signed their treaties

in line with the OECD MC. It is therefore important from the perspective of this thesis to scrutinize article 5 of the OECD MC thoroughly. This article being important for the purposes of tax treaties has not been changed for a considerable time span until the year 2017. The concept of the permanent establishment has progressed over the period of years and through the commentary on the OECD MC. As regards to the BEPS Action 7 “Preventing the Artificial Avoidance of Permanent Establishment Status”<sup>37</sup>, some important changes were proposed to article 5 of the OECD MC.

- To begin with article 5<sup>38</sup> gives a brief definition of permanent establishment, (para 1)

*“.. the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.”<sup>39</sup>*

- Paragraph 2, lists some of the examples of what a Permanent Establishment typically includes. For instance, where an enterprise YZ that is a resident of State A is operating its business activities in State B and has a place of management or a branch, an office, factory or a workshop in the other State B, it can be concluded based on the other relevant facts and circumstances that the concerned enterprise YZ has a PE in state B.

- Paragraph 3, gives a clarification and explanation on a type of PE, construction permanent establishment. A threshold of 12 months has been stated in this paragraph. Considering the above example if the enterprise YZ undertakes a construction project in State B for a continuous term of more than 12 months, it can be concluded (subject to relevant facts and circumstances) that YZ has a PE in State B.

- Paragraph 4 (exemptions), enlists an important clarification and examples as to what is not included or should not be termed as Permanent Establishment. It is important to highlight in this regard as to what may not constitute a PE in a given jurisdiction. Countries often tend to engage in disputes as to whether a PE exists in a given jurisdiction and what business activity amounts to exemption. A detailed analysis along with relevant case laws is discussed in the following paragraphs.

- Paragraph 5, explains in detail the concept and some criteria to identify a dependent agent PE. This is one of the types of PE and is discussed in detail in the following paragraphs.

- Paragraph 6, further explains the exception of independent agent.

- Paragraph 7, explains the situation on subsidiary companies.

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<sup>37</sup> See, OECD BEPS Action 7- Final report 2015.

<sup>38</sup> See, OECD Model Convention, 2017, Article 5. Here all the sub points of this article have been discussed and explained in detail. Also, the commentary on Article 5 OECD Model gives a clear understanding of the concept of Permanent Establishment.

<sup>39</sup> See, Article 5 OECD Model convention, 2017.

- Paragraph 8, gives an explanation on the enterprises that are closely related.

Based on the analysis of the above-mentioned points and considering the facts and circumstances of every case it can be concluded whether a PE exists in a given jurisdiction. Some of these paragraphs will be discussed in detail in the following points and chapters to answer the research question of this thesis. The author intends to study and analyse the relevant literature and case laws in this regard.

### **3.2.1 LIST OF CONSTRUCTIVE EXAMPLES TO IDENTIFY THE EXISTENCE OF A PE**

As mentioned above, article 5(2) of the OECD model lists some of the examples whose presence can constitute a PE in a given jurisdiction. It is pertinent to note that though a list has been mentioned in this article, these examples still have to be tested against the basic criteria of article 5(1) of OECD MC. Therefore, only on the basis that a workshop or a factory of a non-resident is present in the other contracting state should not by itself constitute a PE in that other state<sup>40</sup>. For instance, assuming that an architect who is a resident of state X visits his family in state Y. This visit is for a short period, but eventually, he decides to rent an office in state Y in a co-working space so that he can manage his business from this place during his visit. Now, in this situation, considering article 5(2)(c) of the OECD MC, though an office is said to constitute a PE in a given jurisdiction, it is much likely that it would not stand correct in the above situation. Though the architect is carrying on his business in state Y, it is for a very short period and therefore is not likely to satisfy the ‘tempus test’ i.e. the duration. Therefore, in such a situation one cannot say that a PE exists in state Y. The tempus test and the other relevant criteria for identification of PE have been explained in detail in the following paragraphs.

### **3.2.2 PREPARATORY AND AUXILIARY ACTIVITIES; EXEMPTIONS TO THE MAIN RULE**

As explained above article 5(4) of OECD MC gives a list and clarification as to what activities or business operations do not constitute a PE in a given jurisdiction. It is important to understand this list in details along with relevant case laws as businesses and countries often get into disputes whether a business operation falls under the exemption list of this article or constitutes a PE. Such activities or business operations are referred to as preparatory or auxiliary services i.e. an activity which is not considered intensive and is of supporting nature. Many businesses have to set up a supporting activity to help their main business operations. Therefore, these activities should not lead to PE<sup>41</sup>. However, the above explanation will not stand correct if such supporting activities go past the preparatory or auxiliary

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<sup>40</sup> See, Roy Rohatgi, p. 142.

<sup>41</sup> See, OECD model convention, 2017, Article 5(4).

nature, in that case, all these activities may constitute a PE. Thus, where a business activity does not play a significant role in the overall business operations of the enterprise shall not be deemed to constitute a PE in itself. It is, therefore, necessary to consider this on the facts and circumstances of each case thereby. It is important to identify the core activity of a business and the characteristic of the activity to be considered under the exemption. For instance, let us consider two examples in this regard,

Example a) Assuming company X is a resident of State A and has manufacturing business in the same state it also delivers its products to State B and C through its transport. For the purposes of convenience, it has a warehouse in State B for the storage of its manufactured goods. The main distribution channel takes place through its resident State A. The goods stored in State B is just for the purpose of convenience and nothing else. In this case, it can be argued that the main business operation of manufacturing and distribution is in State A and therefore the storage warehouse qualifies for exemption according to article 5 (4) of the OCED MC and hence, does not constitute a PE in State B.

Example b) In the second situation, the same company X which is a resident of State A, conducts its business operations of selling products via a website. Accordingly, it owns a warehouse in State B where all its products are stored. The company uses this warehouse so that it can easily transport goods to the customers nearby for easy commutable delivery. It is pertinent to note that in this situation, the warehouse that is owned by company X for the purposes of delivery forms a core part of its business activity. Therefore, in this situation, the warehouse will not qualify as an exemption under 5(4) of OECD MC and thereby will constitute a PE of company X in State B.

On the other hand, businesses usually take undue advantage of these exemptions and some entities tend to artificially split up various parts of a composite activity to avail this benefit and fit under the criteria of preparatory and auxiliary activities. Thus, BEPS Action Plan 7 is aimed to address this situation. It is not possible to avoid PE status by fragmenting the cohesive activities into a small operation and thereby argue that each part merely engaged in preparatory and auxiliary activities. Below mentioned is relevant case law in this regard.

A case had come up recently before Indian tax courts. In this case<sup>42</sup> of UNION OF INDIA vs U.A.E Exchange Centre civil appeal no. 9775 of 2011 dated 24<sup>th</sup> April 2020 some interesting take away relevant to the above topic have been listed below.

**Brief facts and takeaways from decision:**

Normally the non -resident entities form a Liaison Office (Hereinafter: LO) / Branch Office (Hereinafter: BO) and claim that LO/BO is set up for providing support activities.

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<sup>42</sup> UNION OF INDIA vs U.A.E Exchange Centre, Civil Appeal No. 9775 of 2011, (2020) 107 CCH 0426 ISCC.

In this case, a Liaison Office was involved in facilitating monetary remittance services in India. The question arose whether services rendered by LO constitute PE or is it exempt being carrying preparatory and auxiliary services? The relevant treaty in this regard was India – UAE treaty. The taxpayer was incorporated in UAE. The assessee was UAE Exchange Centre. It was engaged in offering remittance services for transferring monies from UAE to various places in India. After collecting remittances from Non-Resident Indian (Hereinafter: NRI) in the UAE, the assessee was then remitting funds on behalf of the NRI by following two modes – 1. Transferring funds through banking channels and 2. Sending instruments or cheques through its LO to the beneficiaries designated by its customers. The contract underlying this activity was executed in the UAE. The LO remained connected with main server in the UAE for remittance of funds to beneficiaries in India. The LO was permitted to undertake following activities only – a) Responding to queries from the correspondent banks, b) Undertaking bank reconciliation of bank accounts held in India with correspondent bank, c) Acting as communication centre, d) Printing drafts and cheques and dispatching it to customers, e) Following up with the correspondent Indian bank. It is also important to note that the LO was not permitted to carry any other activity of trading and commercial nature. The LO was not charging any commission for its role. No other income was earned by LO and it had no immovable property. Also, all the expenses were taken care of by the Head office. Further, the assessee i.e. the U.A.E enterprise had first approached Authority for Advance Ruling (Hereinafter: AAR) to seek a determination of question of the existence of PE. AAR ruled against assessee and has held that activities carried out by LO lead to formation of PE. The reasoning of AAR ruling was LO is carrying activities which is part of main contract of remittance delivery, and therefore it constitutes PE. The decision of AAR has been challenged in Delhi High Court of India (HC). The HC has decided in favour of the assessee that it is exempt being involved in carrying preparatory and auxiliary services. The HC judgment was further challenged in the Supreme Court of India (Hereinafter: SC). When the role of LO was looked upon, it was noted that LO's activities were to download information through electronic media, based on which cheques were drawn on the bank and dispatched to the beneficiaries in India. While reaching to this conclusion the SC drew support from approval granted by Reserve Bank of India (Hereinafter: RBI) as per which LO was permitted to undertake restricted activities. Thus, the court held that the term “preparatory” and “auxiliary” is not defined in the relevant treaty. Hence, one has to go by dictionary meaning i.e. these activities mean supporting activities. Therefore, looking at permission granted by RBI and nature of activities carried out, it can be stated that LO's activities fall under the ambit of “preparatory” and “auxiliary” services and does not constitute a PE.

The above examples and case law give a clear understanding of how complex can the businesses be and thereby whether to consider an activity under the exemptions mentioned in the OECD MC or the other relevant tax treaties.

### 3.3 TYPES OF PERMANENT ESTABLISHMENT

#### 3.3.1 FIXED PLACE OF BUSINESS

One of the most simple and clear explanations of a Permanent Establishment, as defined in article 5(1) of the OECD MC as well as the United Nations Model Convention (Hereinafter: UN MC) is “a fixed place of business through which the business of an enterprise is wholly or partly carried on”<sup>43</sup>. Thus, the main characteristics to be highlighted in this regard are, the “place of business” which indicates a particular place to be identified for conducting the business activities such as an office or a branch. It is important that such place shall be “fixed”, i.e. the characteristic of fixedness is relevant. Further, the definition explains the connectivity and the dependency of such business in the PE state with the resident enterprise of the other state. The part “carrying on of business” shows that there is dependency on the resident state enterprise for the business activities to be carried on in the PE state. These are some of the vital as well as relevant characteristics to conclude the existence of a PE in a given state<sup>44</sup>. Following these, the OECD commentary on article 5 sets out five important tests to be checked before confirming the existence of a fixed place of business<sup>45</sup>.

1. **Situs Test-** Under this test it is necessary to analyse a physical place of business in a given jurisdiction. Physical construction of place of business needs to be identified such as an office, premises, some of the machinery or equipment. It is important to note that this term as explained in the OECD model commentary can have a wider meaning and mostly covers the tangible assets. Thus, intangible assets such as patents cannot constitute a PE in this regard<sup>46</sup>.
2. **Locus Test-** This test indicates the geographical location, which also denotes and indicates a degree of permanency which must be checked. This means the business must be identified in a given jurisdiction or place other than the resident state. This also means that the business is commercially as well as geographically engaged. Therefore, it is important to establish a link between the location and the business, for instance, a satellite cannot be concluded as a PE since it is not a part of any specific territory<sup>47</sup>. It is also pertinent to note that many business activities might consist of moving around in the nearby location to conduct its activities. In such a case a particular place of business is considered as a fixed place of business. Such situations might arise in mining businesses or outdoor markets<sup>48</sup>.

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<sup>43</sup> See, OECD Model Convention, 2017, Article 5(1).

<sup>44</sup> OECD Model Commentary, Article 5(1).

<sup>45</sup> Fundamentals of Permanent Establishment, Robert L Williams, p.16-20.

<sup>46</sup> Roy Rohatgi, Vol.1, p. 136.

<sup>47</sup> OECD Model Commentary, Article 5. Paragraph 27.

<sup>48</sup> OECD Model Commentary, Article 5. Paragraph 23-25.

3. **Tempus Test-** The locus test and the tempus test are well connected and specifically aim to highlight an assured degree of permanency. This focuses on the aspect that the concerned business is not of a very short period and temporary in nature. Though there is no clear definition of the period, it can be concluded that a business activity that typically lasts for at least six to twelve months. The intent of an enterprise to conduct its business activities for a longer period or a considerable time span is relevant under this test. Thus, the starting and the end dates of business activities need to be recorded subsequently to avoid disputes between jurisdictions. A considerable period of time need not be at one stretch. As per the OECD commentary on article 5, the place of business being used need to be ascertained in combination with how many times it has been used over a period of time. For instance, a company resident in state X conducts research business and performing scientific analysis in a location that can be accessed for only 3 or 4 months in a year due to the weather conditions in that place. But since this place is being used for a continuous number of years it can be concluded that a PE exists in such a state because of the recurring nature of such business over a continuous period of time<sup>49</sup>. On the other hand, some businesses can be of a short span. Considering a situation where an enterprise resident of state X buys a stock of goods to sell at an exhibition in state Y. This exhibition lasts for a period of 4 to 5 months. In such a case, though the period of business activity is relatively less because of the nature of the business, it can still be concluded that a PE exists in state Y. Thus, it is important to deal with every situation on its facts and circumstances considering the intention of taxing the profits that are attributable to a particular jurisdiction<sup>50</sup>. Subsequently considering the intention of a business can also constitute a PE since the beginning even if such business comes to an end abruptly<sup>51</sup>.
  
4. **Ius Test-** The Ius test refers to the place of business. The place of business where the non-resident enterprise carries on its business operations in that other state must be either legally or factually at the disposal of the non-resident enterprise. Such a place can be either rented or owned or may be shared by some other enterprise, the specific condition being “at the disposal” of the non-resident enterprise. Thus, we can conclude that this test refers to the controlling aspect of the situs test<sup>52</sup>. Further, it is important to highlight three main points to be considered in this regard<sup>53</sup>;

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<sup>49</sup> OECD Model Commentary, Article 5. Paragraph 29.

<sup>50</sup> OECD Model Commentary, Article 5. Paragraph 30.

<sup>51</sup> OECD Model Commentary, Article 5. Paragraph 34.

<sup>52</sup> Fundamentals of Permanent Establishment, Robert L Williams, p.16, p.32-44.

<sup>53</sup> Fundamentals of Permanent Establishment, Robert L Williams, p.32.

- It is possible that the non-resident enterprise owns this place of business (for instance an office) in the other state. In this case, the office owned by such an enterprise will be at its disposal and therefore under its control for carrying out the business activities.
- In the second situation, it might be possible that the non-resident enterprise has rented the place of business (for instance an office) in the other state. Even in this situation though the office has been rented, it is fully at the disposal of the non-resident enterprise and therefore under its control for the relevant business activities.
- Finally, in the third situation, it is possible that the non-resident enterprise is using a place of business (for instance an office) in the other state, which is owned or rented by some other enterprise but is still “at the disposal” or under the control of the non-resident enterprise for carrying on its business activities.

In all of the above three situations, it can be concluded that the non-resident enterprise has a place of business which is “at the disposal” i.e. under the control of such enterprise. By analysing these situations depending on respective facts and circumstances the ius test can be checked and the fixed place permanent establishment can subsequently be concluded subject to above-mentioned points. It is pertinent to note that the term “at the disposal” was nowhere mentioned in the earlier OECD model conventions. This became part of the OECD commentary in 1974. It is pertinent to note that the term still has a lot of ambiguity and needs more clarification as a business can be conducted in various forms. It is not necessary that a particular premise is always available to the enterprise that is owned or rented. For instance, a small outdoor market pitch can also constitute a place of business and therefore an office or equivalent premises being rented or owned or leased and at the disposal of the enterprise seems to be irrelevant in this regard.

Referring to the OECD commentary in this regard also does not deal with the problem in complete understanding of this term. The OECD commentary mentions some examples in this regard. Two of these examples are not so informative, another one is just enough to understand the situation and therefore can raise some questions and the last one is disapproved by some of the case laws<sup>54</sup>. The question to be addressed in these examples is that where an employee of a non-resident enterprise visits the premises of its subsidiary for ‘long period’ to confirm compliance of the contract with such subsidiary, in this situation considering the long period mentioned in the example might result in a PE being concluded in that jurisdiction<sup>55</sup>. On the other hand, without mentioning the period of such a visit it will be difficult to conclude a PE in a given jurisdiction. It is a settled position that a parent company has the rights to supervise its contracts with its subsidiary and thus this example is much relatable to the exemptions

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<sup>54</sup> Fundamentals of Permanent Establishment, Robert L Williams, p.33.

<sup>55</sup> OECD commentary, Article 5.

mentioned in article 5(4) of the OECD MC. Another interesting example mentioned in the commentary is about the painter painting a big office of one of his clients. This painter visits this site for some fixed number of days for a long period of time. The question is this situation was if the office site constitutes a PE? This view has been criticised in the literature as well as in a case from Germany<sup>56</sup>. It has been argued that there is no PE since the office site is not at the disposal of the painter and is just an ordinary 'object' of his business. The author of this thesis agrees with this view as the place of business being at the disposal is one of the vital factors of determining a fixed place PE.

There have been many disputes between jurisdictions concerning this topic and subsequent case laws. The interpretation of 'at the disposal' is the most vital of all which further implies control of a non-resident enterprise. Some of the important points to consider in this regard is the use of client's offices and equipment or the use of home offices. When employees of a non-resident enterprise use such offices or work from home offices, the relevant question that arises is whether that place is 'at the disposal' of the non-resident enterprise or not? It is important to establish the concept of control in this regard to determine whether a fixed place PE exists<sup>57</sup>. In one of the leading case laws, this issue was tackled comparable to the painter example as mentioned above. In the case *Dudney vs. Regina*, William Dudney was a resident taxpayer of Houston and was engaged as an independent contractor for training purposes of employees of a company in Canada. He, therefore, visited Canada and carried equipment along with him for the same. He stayed there for 340 days in two years. He was provided with different offices at the premises according to the Canadian company for this purpose. Sometimes a small room sometimes a larger one and at times even the conference room. In this case, the Canadian court held that Dudney had no fixed place of business under his control, therefore the premises were not 'at his disposal', hence, there was no PE in Canada<sup>58</sup>.

In another leading case of *Rolls Royce vs. DDIT*<sup>59</sup> the question arose whether a fixed place PE exists in India. The UK based manufacturer had a subsidiary in India whose relevant office expenses were taken care of by Rolls Royce at a mark-up of 5%. In this case, the employees often visited India and the place of business (premises) were at the disposal of the UK based manufacturer. Hence, it was concluded that the fixed place PE exists in this case. These examples and case laws give us a clear understanding of the interpretation of the term 'at the disposal' and a detailed clarification as to the use of client's place of business and the concept of PE in that regard.

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<sup>56</sup> Decision in *Bundesfinanzhof*, IR 30/07, 4<sup>th</sup> June 2008.

<sup>57</sup> *Fundamentals of Permanent Establishment*, Robert L Williams, p.35-44.

<sup>58</sup> *Dudney vs. Regina*, 99 DTC 147 (T.C. Canada 1998).

<sup>59</sup> *Rolls Royce vs. Deputy Director of Income Tax (ITAT Delhi, October 26, 2007)*.

The other aspect in this regard is the home offices used by employees or relevant personnel thereof. This often creates a lot of disputes between countries as to whether a PE exists in a given jurisdiction where employees of a non-resident enterprise work from their home offices. This depends on every case and its facts and circumstances as to whether the home office constitutes a fixed place PE. Below are some of the case laws in this regard which will help analyse this concept with more clarification.

In *Universal furniture Ind. AB vs. Norway*<sup>60</sup>, a Norwegian salesperson was appointed by a Swedish company involved in the furniture business. This salesperson operated from Norway and on some of the days at the end of the week operated from his own home office, updating the sales report and planning the work of the week ahead. It is pertinent to note that in this situation the Swedish company took care of the expenses of the home office of the Norwegian sales person. These expenses included the phone used in the office, fax and the relevant equipment thereby. These were reimbursed from time to time and later through some allowances. Thus, in this situation, the Norwegian court concluded that the Swedish company has a fixed place PE in Norway. The author agrees with the decision in this case as the salesperson concerned was operating for the sales of the company in Swedish and thereby contributing to the income generation aspect of the business. Also, the Swedish company was taking care of the relevant business expenses and therefore it can be argued that it had the place at its disposal, meaning their business operations were being carried on successfully.

From the above analysis, it is important to note that, wherein most of the disputes the non-resident enterprise argues and is in denial of having a PE in the source country, on the other hand in some of the cases the situation and arguments can be in complete contrast to the above-mentioned situations. In some situations, having a PE in the source country is also beneficial for the non-resident taxpayer, as the taxpayer can claim deductions in its own country of residence based on the profits of PE in the source country. This conclusion can be noticed in the case of *Sunbeam Corporation vs. Minister of National Revenue*<sup>61</sup>, where the taxpayer could have had a benefit if the court would have concluded the existence of PE in Quebec. This however, is only possible in some of the jurisdictions as regard to the tax rules and provisions therein. This is mostly observed from the European and Canadian PE cases<sup>62</sup>.

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<sup>60</sup> *Universal furniture Ind. AB vs. Norway*, Stavanger Byrett, Case No. 99-00421 A, 19 December 1999 Stavanger County Court. Also discussed in Williams at p.42 along with other similar case laws on home office PE.

<sup>61</sup> *Sunbeam Corporation Ltd. vs. Minister of National Revenue*, (2012) 18 Taxmann.com 213 (S. Ct. Canada).

<sup>62</sup> *Fundamentals of Permanent Establishment*, Robert L Williams, p.42-44. This argument is relevant in case of some jurisdictions specifically as explained here along with many other relevant case laws.

5. Business activity Test- Under the business activity test it is important to analyse what business is being conducted and how. Answering these questions shall satisfy the business activity test. Whose business is being conducted in a given jurisdiction can be scrutinized by understanding the business operation and how it is carried on. Whether the business is run by the non-resident enterprise employees, or contractors or a server that requires no human interference or can be dependent or independent agents. Further, it can also be examined whether a particular business activity is a core activity of the business or is of a preparatory or auxiliary nature. In case such business activity amounts to preparatory or auxiliary nature it is exempt as stated under article 5(4) of the OECD MC and therefore cannot constitute a PE<sup>63</sup>. With various forms of businesses, it is possible that a particular business operation or equipment may not require any human interference or input of employees from the non-resident employee state or the source state, and is yet capable of generating income. For example, let's take into consideration equipment that is used for gaming purposes or a server or a pipeline etc. Such business setups which are not exactly operated or coordinated by employees in the source country or by the non-resident enterprise personnel physically are capable of generating income. Such businesses can be operated for the resident state from the resident state itself. Such situations also lead to constitute a fixed place PE in the source country<sup>64</sup>. These business activities that form the core of business operations can very well support such arguments in favour of source country taxation and identification of a PE. To elaborate on the above-mentioned example, if an enterprise has set up a pipeline to transport its gas, such setup does not constitute a PE as it shall fall within the scope of exemptions as listed under Article 5(4) of the OECD MC. But, on the other hand, if the same pipeline has been set up to transport gas of a third enterprise in return of payment for the same, then such setup may constitute a PE as this satisfies the business activity test. Similarly, any other activity that does not require any operation or activity in the source country, but forms a core part of the business activity and thereby generates income may constitute a fixed place PE<sup>65</sup>. Related case law in this regard has been discussed below.
- In the case of Swiss Server<sup>66</sup> an internet server was kept in a leased property in Switzerland. This property was leased in the name of a German company. However, this server did not require any sort of work to be carried on by the employees in Switzerland or employees of the non-resident taxpayer. Even though it contributed to the core business activities of the company in Germany by providing data to its swiss clients and therefore the court concluded that a PE existed in Switzerland. It is pertinent to note that the server that was stored in the location was not kept merely for the purposes of storage or any other auxiliary nature and hence does not

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<sup>63</sup> See, OECD model convention, 2017, Article 5(4).

<sup>64</sup> Fundamentals of Permanent Establishment, Robert L Williams, p.44.

<sup>65</sup> Fundamentals of Permanent Establishment, Robert L Williams, p.45. Many of such examples and case laws have been discussed here similar to the situation explained above.

<sup>66</sup> Schleswig-Holstein Tax Court judgement of 6 September 2001, II 1224/97 – EFG 2001, 1535 = SWI 2002, 17.

qualify for exemption under article 5(4) of the OECD MC. A pipeline, gaming equipment or vending machines are some of the other examples in this regard.

On the other hand, it is important to note that mere presence of premises or a property of the non-resident enterprise does not in itself constitute a PE. It is important that the business activity of the non-resident enterprise is being conducted in such a place. Such business activity can be the core operation of the business or of any other supporting nature other than the preparatory or auxiliary nature<sup>67</sup>. In the case of *MNR vs. Tara Exploration and Development Co. Ltd.*<sup>68</sup> an Irish resident company used the office space of its related company in Toronto. This office space was used for the purpose of compliance in Canada. However, it was not used for any of the business operations of the Irish company. Hence, the court in this case concluded that there was no PE in Canada. Similarly, simply leasing or renting of premises or any such property does not constitute a PE in itself<sup>69</sup>. It is important to satisfy the business activity test in this regard.

### **3.3.2 AGENCY PERMANENT ESTABLISHMENT**

Agency PE is one of the most elaborately discussed type of PE in the article 5 of the OECD MC. To be precise article 5(5) of the OECD MC gives a detailed clarification as to who is a dependent agent. Further, article 5(6) discusses about an independent agent. Based on these criteria and conditions one can identify whether a given jurisdiction has an agency PE or not. Based on the below mentioned conditions, a dependent agent PE can be located for a particular jurisdiction. Where a non-resident enterprise conducts its business activities through a person or an agent in the other contracting state, there is a possibility of having a PE in that other state based on the business activity carried out by the agent. The OECD MC article 5(5) lists some of these conditions to point out such dependent agent.

- A Person in a contracting state is acting on behalf of an enterprise,
- habitually concludes contracts or plays a leading role in them without much alteration by the enterprise,
- the contracts concluded are in the name of the enterprise.
- Also, the said person has the right to use the services and the right to use the property owned or which is 'at the disposal' of the enterprise.

These are some of the pointers that determine if there is a dependent agent in the concerned jurisdiction. If the above pointers are met there is a high possibility that there is a permanent establishment in that jurisdiction where the activity is exercised. It is important to note that the dependent agent and the non-

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<sup>67</sup> Fundamentals of Permanent Establishment, Robert L Williams, p.46.

<sup>68</sup> *MNR vs. Tara Exploration and Development Co. Ltd.* (1974) S.C.R. 1057.

<sup>69</sup> Fundamentals of Permanent Establishment, Robert L Williams, p.44-50.

resident enterprise are legally distinct from each other<sup>70</sup>. This dependent agent can either be a person or a company and it is not necessary that the same is a resident of the state in which it is performing its activities on behalf of the other enterprise<sup>71</sup>. The subsequent contracts that relate to such activity must form a core part of the business of the enterprise. For example, a company A that is resident in state X, sells its products through company B that is resident in state Y. The contracts concluded in state Y are on behalf of the company A. Here company B performs this activity habitually for company A. Also, the ownership of the goods is with company A, and company B habitually works for transfer of these goods to a third-party customer. In this situation, all the conditions as listed above are met and therefore one can conclude that company A has a dependent agent PE in state Y.

Further, two exceptions can be noted in the case of dependent agent PE. First, where the dependent agent performs the activities as mentioned in article 5(4) of the OECD MC, that stipulates the exemption activities as mentioned above in paragraphs 3.3 and 3.3.2 of this thesis, no dependent agent PE exists. Hence, there is no existence of dependent agent PE, if the said agent performs activities relating to the preparatory and auxiliary nature. Second, where an independent agent is identified as regard to article 5(6) of the OECD MC. Simply put, where the activities carried out by an independent agent performing in ordinary course of his business, does not constitute a PE in that state<sup>72</sup>. In this regard it is important to analyse certain factors such as dependency on the non-resident enterprise, which can be determined by the level of freedom that such an agent enjoys while concluding contracts<sup>73</sup>. Next is the risk borne of the business activity. It is necessary to check whether the risk is borne by the enterprise or not, as in that case the agent cannot be regarded as an independent agent. The overall business activity of the agent also needs to be scrutinized. Where an agent for instance, is working for a specific enterprise exclusively for its entire time span, in that case it cannot be said to be an independent agent<sup>74</sup>. These abovementioned factors determine whether an agent can be termed as a dependent or an independent agent. Also, where a person is acting on behalf of one or more closely related enterprises exclusively or almost exclusively, even in this situation that person cannot be termed as an independent agent<sup>75</sup>.

It is also pertinent to note, article 5(5) i.e. dependent agent and article 5(6) i.e. independent agent of the OECD MC were amended in the year 2017, as regard to the BEPS project Action 7, final report (2015). This amendment was included so as to tackle the BEPS issues of artificial avoidance of PE through commissionaire arrangements and equivalent plans thereon. As regard to the OECD MC 2014, article 5, it was possible for a non-resident enterprise to sell its products through a commissionaire in some other jurisdiction without triggering a PE in that state. Therefore, the commissionaire could only be

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<sup>70</sup> See, Roy Rohatgi, p. 154.

<sup>71</sup> See, OECD model commentary, 2017, on Article 5, paragraph 86.

<sup>72</sup> See, OECD model convention, 2017, Article 5(6).

<sup>73</sup> See, OECD commentary, 2017, on Article 5, paragraph 104-109.

<sup>74</sup> See, OECD commentary, 2017, on Article 5, paragraph 104-109.

<sup>75</sup> See, OECD commentary, 2017, on Article 5, paragraph 111-112.

taxed on the remuneration that he received for his activity and no profits were attributed to the other state. Such situations were taken care by the above-mentioned amendment.

#### **4. PERMANENT ESTABLISHMENT RISKS IN THE TIME OF CRISIS [COVID 19]**

##### **4.1 INTRODUCTION**

The COVID19 pandemic has disrupted many organisations and countries in many ways. All countries around the world have suffered and people have suffered terrible damages in terms of health as well as financially. It has forced all governments around the globe to take some strict measures in respect of traveling and working. Many companies and multinationals have suffered losses. Impact of implementing quarantine and lockdown measures where people are not able to travel to their ordinary work places has hit many individuals and companies and accordingly are forced to change their working conditions. Due to this, internationals who used to travel for work in other jurisdictions and execute their duties physically in those jurisdictions is temporarily not possible in the current scenario. This therefore has resulted in either individuals/cross-border workers losing their jobs or are forced to work from home or in any place where they are residing and are not able to travel to their usual place of work because of the various measures implemented by the governments and travel restrictions. As a result, this extraordinary situation is giving rise to many tax issues in all jurisdictions. Especially where individuals are working for organisations in different jurisdictions or a country which is not their country of residence. Accordingly, this can also potentially give rise to the risks of a PE being created in that jurisdiction where the individual is working for an enterprise in another jurisdiction. This may eventually result in disputes between countries over the right to tax the profits in such cases. In all ordinary situations i.e. where the world is not hit by a pandemic and where there are no travel restrictions by governments, such situations may give rise to a PE and the profits would be allocated based on the relevant tax treaties as discussed in chapter 3. But considering this unprecedented situation of COVID19 where the home office and working in different countries where a person is residing temporarily because of the travel restrictions is a mandate by the government and not a requirement of the businesses, some additional guidelines are necessary to be followed by the countries in relation to a PE. Thus, this chapter discusses in detail such situations based on the recent guidelines published by the OECD in this regard.

##### **4.2 RISKS OF CREATING A PE IN THE TIMES OF COVID 19**

It is unfortunate that the world is currently facing a pandemic and this has caused great loss to humanity and countries worldwide. This COVID 19 pandemic is unprecedented in many senses. It has certainly created chaos across the globe. It has confined people in their homes, factories have been shut and streets deserted. Every person willingly or unwillingly is forced to follow government rules and

regulations including work from home. For the business to salvage the situation of damages in general and specially to reduce commercial losses, reminds me of a famous phrase; ‘the show must go on’. So, work from home has become the new “normal” way of life. The previous physical meetings have been actively exchanged to online meetings. For multinationals, it is very common that they employ cross border talents and their employees keep travelling for fulfilment of business contracts terms of deliverables and that too in time-bound manner. This has led lot of employees to e-working. A critical consideration in such e-working / work from home leads to exposure to PE for Multinational corporations (Hereinafter: MNCs). Thus, an employee on MNCs, works from home in a different country than in country of his employment, can trigger a PE risk subsequently. It is established and as explained in the above chapters, that to constitute PE certain tests like fixed place test, permanency test, disposition test etc. need to be satisfied. The concept of home office PE is elucidated in OECD commentary, especially under such circumstances. If work from home practice is a temporary and is result of stop-gap arrangement like in the current scenario of COVID 19, then it would not satisfy the test of permanency and may not pose exposure for the establishment of PE. In the contrary position of work from home is a continuous arrangement instead of providing office, then it may give rise to exposure of PE. Home office may be considered at the disposal of an enterprise. The home office concept has also been discussed in para 3.4.1 of chapter 3.

A lot of judicial precedents and guidelines can be listed as regard to this topic. Austrian Supreme Court has in various rulings in the past held that a PE can be established at a private home of an employee. The Danish National Tax Tribunal in a case involving an employee who relocated from the UK to Denmark due to illness, considering his activities of only supporting nature for his colleague with limited contact was held to be of preparatory and auxiliary nature and not construed as a PE. However, recently tax authorities have held that wherein work from home, core activities like sales, marketing activities are carried out, there is an existence of PE. Considering this scenario specially because of circumstances created by COVID 19, work from home is only because of government directives of respective countries, on the other hand, international business came to a halt and can it be compared with normal circumstances? Is it a requirement of an enterprise? Though to get a clear answer on this, one has to wait for judicial precedents, but MNCs are advisable to maintain enough documents that in what circumstances work from home was adopted and what kind of activities were rendered. This kind of situation has happened unexpectedly, and it is not repetitive. It requires due attention and impulsive decisions or wrong interpretations can lead to risks of PE exposure and it will create a lot of unwarranted hardships for businesses and taxpayers.

In a case of construction PE, every treaty provides for a minimum time threshold to exceed. If the prescribed threshold is not exceeded, then there is no existence of PE. During regular circumstances and activities, there could be temporary interruptions on account of many causes. It is established that

such temporary interruptions are not excluded from the threshold for calculation of days of PE<sup>76</sup>. in this situation of COVID 19, the interruption is temporary. But certainly, it is not interruption like caused by a shortage of material, weather conditions and so whether it will be treated as a normal interruption or an abnormal situation is yet to be confirmed. It is definitely one of the vexed issues and will be addressed by the courts accordingly. As regards to this, in of the case that came up before Delhi High Court of India in case of National Petroleum Construction co., wherein it was held that where the site has not been accessed for long duration and no activity was carried out, in such a situation that period should be excluded from the threshold of PE<sup>77</sup>.

The distinction also needs to be drawn on whether this interruption due to the pandemic is slowing down the work or is there stoppage of work. If gradually it has resulted in complete stoppage of work, certainly it has to be excluded from PE threshold. If COVID 19 is causing stoppage of work or cessation of activities for long duration, there exist strong argument that it should be excluded from the threshold of calculation of the existence of PE.

Some countries have already issued guidance on account of COVID 19 situation. Similar guidance is available from Ireland Revenue. If an individual is present in Ireland and that presence is shown because of restriction on travels because of COVID 19, the revenue has to disregard such presence for taxation purposes, for a company in which such an individual is an employee, director, service provider or an agent<sup>78</sup>. Germany and Netherlands agreement as a quasi- protocol to the existing treaty which entered for clarifying and bringing relief to employees of multinational enterprises in the COVID 19 scenario from personal income tax and home office scenarios. Some countries have issued guidance proactively. This will lay down persuasive value where there is no guidance from other countries. If countries by and large issue guidance regarding such situations, then it shall save resources of businesses and countries to invest in litigation.

As stated above, the situation of COVID 19 has triggered many questions and disputes from the international tax perspective. The changed business conditions have raised many questions in different jurisdictions as to the establishment of a fixed place PE or the threshold in construction PE. The OECD in this regard has issued some guidelines. Though such guidelines are always difficult to implement because of a variety of different facts and circumstances, it definitely will provide a starting point as to the clarifications for businesses. According to OECD, for a fixed place PE to be located in a jurisdiction, it is important that such business activity meets the permanency test. Also, it is necessary that the so-called home offices of the employees have to be at the disposal of the non-resident enterprise. These concepts have been discussed and analysed in the above chapter 3 of this thesis. Without satisfying

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<sup>76</sup> See, OECD commentary, 2017, on Article 5, paragraph 54-55.

<sup>77</sup> National Petroleum Construction vs Director of Income Tax, 29 January, 2016, ITA 143/2013.

<sup>78</sup> See, OECD Secretariat analysis of tax treaties and the impact of the COVID 19 crisis, 3rd April 2020.

these tests, it is unlikely that a PE will be constituted in any jurisdiction<sup>79</sup>. The situation of COVID 19, though has been present for a considerable amount of time, the home office working environment cannot be termed as a long-term activity and therefore shall not trigger the PE risk within a country.

Similarly, where an agent concludes contracts temporarily from his home country rather than his normal place of business, should not create a dependent agent PE by itself, specifically where such business activity is of a temporary nature. It is important to note in this regard that such working conditions may be forced due to government measures and is not a mandate by the business in itself.

### **4.3 RISKS RELATING TO A ‘HOME OFFICE’ IN THE TIMES OF COVID19**

In view of this thesis it is important to address this topic of ‘home office’ which simply means working from home. As mentioned in the introduction, due to the pandemic many countries have imposed travel bans and restrictions to tackle the spread of COVID19, many companies and multinationals have suffered losses and the ease of doing business as in normal situations has changed. Employees working for multinationals in different countries are not able to travel because of these restrictions. In this scenario, the concept of home office or working from home has emerged as a new way of working for such employees who are stranded in different countries which may or may not be their original country of residence. As discussed in chapter 3, such a working condition in normal situations without any travel restrictions might create a PE in that jurisdiction depending on the case and analysis mentioned in chapter 3. But, the current model of working from home has been adapted by companies and multinationals as an alternative to keep the business activities running despite of the various travel restrictions and measures imposed to tackle COVID19 by the governments of different countries. In such a condition, based on the interpretation of treaties, there is a high probability that the tax authorities in every country would consider the existence of a PE in their respective jurisdiction and would tax the company accordingly based on the activities of a PE.

In the above-mentioned situation, it is pertinent to note that this concept of home office or working from home, especially in the times of COVID19 is implemented as a result of government restrictions and travel bans and is therefore not a mandate or requirement of the business itself. Thus, according to the OECD guidelines<sup>80</sup> and analysis in chapter 3, such a situation of working from home of the employees for a non-resident enterprise should not create a PE in that jurisdiction. Initially there was a lot of confusion on this topic as there are no specific guidelines or rules regarding such a situation in any legislature or tax treaties. As a result, it became necessary for the countries and OECD to lay out some guidelines in this regard. As per OECD and guidelines by tax authorities of many countries, it was

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<sup>79</sup> See, OECD Secretariat analysis of tax treaties and the impact of the COVID 19 crisis, 3rd April 2020.

<sup>80</sup> See, OECD Secretariat analysis of tax treaties and the impact of the COVID 19 crisis, 3rd April 2020.

unanimously agreed upon to consider the temporary nature of such working model. In this regard, it is also important to highlight commentary on article 5 of OECD MC, which states that such ‘home offices’ should be at the disposal of the enterprise<sup>81</sup>. Further, in the above-mentioned situation it is true to say that the home offices or home of employees working for such multinationals cannot be said to be at the disposal of the multinational itself. In another view, to nominate a home office as a PE of the concerned enterprise, it is necessary that the office is being used on a continuous basis by the employee and is fully at the disposal of the enterprise. In the above-mentioned situation none of this satisfies the test of nominating the home offices of employees as a PE in that jurisdiction. From the above analysis it is clear that such working from home condition is temporary in nature and is a consequence of the travel restrictions. Also, the home of employees is not fully at the disposal of the enterprise. Moreover, once the travel restrictions are eased the employees have a separate office provided by the companies to work in normal conditions. As a result, it is suggested by OECD and many other countries to ignore and exempt such situations to qualify as a PE in that jurisdiction. This should definitely hold and be implemented until everything goes back to normal and travel restrictions are lifted.

Based on the analysis in chapter 3 and 4 and the above-mentioned explanation the author of this thesis agrees with the exemption of such temporary situations to qualify as a PE in any jurisdiction. But, on the other hand it is pertinent to note that such exclusion should be considered only in this regard where the employee started working from home after the travel restrictions were imposed and goes back to normal working conditions once the restrictions have been uplifted. In any other situation where the employee has been working from home before the pandemic started and the restrictions were imposed, or where the employee still continues to work from home after the restrictions have been uplifted, in such a case it might trigger the risk of PE in that jurisdiction. In the author’s view such cases should be scrutinized in a different manner. As a result, it is vital for companies to maintain a strict record of working conditions and maintain a proper evidence to avoid disputes later with the tax authorities.

#### **4.4 RISKS RELATING TO AGENCY PE IN THE TIMES OF COVID19**

Agency PE is another type of permanent establishments that is the focus of this thesis to highlight the issues of identification and existence of a PE in the situation of the current pandemic. The analysis of Agency PE and existence of such a permanent establishment in the normal situation apart from the COVID19 restrictions have been discussed in detail in chapter 3 of this thesis. Further, it is now interesting to compare the above-mentioned situation in the times of a pandemic where there are several measures taken by governments to subside the effect of the pandemic including the travel restrictions in almost all countries around the globe.

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<sup>81</sup> See, OECD commentary, 2017, on Article 5, paragraph 18.

Where a dependent agent under the article 5(5) of OECD MC creates a dependent agent PE in a given jurisdiction, it means the dependent agent is ‘habitually’ concluding contracts in that jurisdiction as also mentioned in chapter 3 of this thesis<sup>82</sup>. In the current situation it is therefore also important to interpret this concept of ‘habitually concluding contracts’ to establish an existence of Agency PE in any country. Wherein a dependent agent is concluding contracts for an enterprise from his home or any other place where he is residing because of the travel restrictions and measures imposed by governments and thereby working and concluding contracts as an alternative and not because of the requirement of the business, in such a case this should not in itself trigger the Agency PE in that jurisdiction<sup>83</sup>. Furthermore, it is pertinent to note the commentary on article 5 of OECD MC 2014 as well as commentary on article 5, OECD MC 2017, both conclude the similar interpretation stating the need of permanency and that the concluding of contracts by the dependent agent must be ‘habitual’. In any other circumstances with reference to the current restrictions of COVID19, where the dependant agent is working in a country or from his home as an alternative and not as a requirement, should be exempt and the situation should be excluded to create an Agency PE in that jurisdiction<sup>84</sup>.

The author of this thesis agrees with the view of OECD in light of the above analysis. However, it is pertinent to note that such exemption shall not be possible in any other circumstances other than the restrictions of COVID19. For example, where a dependent agent has been concluding contracts from home country before the restrictions were imposed or where he continues to conclude contracts after the restrictions are lifted, in that case the analysis in chapter 3 should hold and the case should be scrutinized accordingly.

## **5. DISPUTE RESOLUTION MECHANISM AND PERMANENT ESTABLISHMENT IN TIMES OF COVID19**

The Mutual Agreement Procedure (Hereinafter: MAP) Article in tax conventions permits an appointed member (the competent authority) from the government of the contracting state shall deal with the resolution of international tax disputes. The conflicts which occur are namely, double taxation including both the juridical and economic situations, as well as dealing with the discrepancies or irregularities and claim of a convention. As regard to the subject of the thesis, the MAP also relevant in settling disputes relating to PE. As stated from the above chapters it is clear that the though article 5 of the OECD MC 2017, provides guidelines as to the identification of PE, each case needs to analyze on its facts and circumstances. Thus, it becomes difficult for jurisdictions in the cases of ambiguity in the article and the interpretation of different jurisdictions accordingly. Hence, in the view of the author, this chapter

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<sup>82</sup> See, OECD model convention, 2017, Article 5(5).

<sup>83</sup> See, OECD Secretariat analysis of tax treaties and the impact of the COVID 19 crisis, 3rd April 2020.

<sup>84</sup> See, OECD Secretariat analysis of tax treaties and the impact of the COVID 19 crisis, 3rd April 2020.

gives a detailed clarification as to MAP, which eventually is one of the guidelines in settling disputes between countries. As stated above in chapter 4, though there are guidelines issued by OECD and some countries, it is highly probable that there might be disputes between countries in relation to home office PE and agency PE in the times of COVID19. The purpose of this chapter is to discuss whether if the MAP is effective in solving such disputes in the above-mentioned situations relating to existence of a Permanent Establishment in the times of COVID19.

To specify, an appointed member or a competent authority can be defined as the “the term used in tax conventions to identify the position, person, or body to whom issues can be addressed within the contracting state that is one of the two parties to a tax convention.”<sup>85</sup> Usually, the competent authority is defined in the Article of tax conventions for each country and the appointed member is Minister of finance or his designated representative or the secretary of the treasury or his delegate as per article 3 of the OECD MC. The most significant point to refer in MAP article, in many of the conventions, the appointed authorities are not obliged in fact to settle their tax disputes and reach an agreement. Instead, they are bound to use their best actions to reach an agreement or consensus. However, many appointed members or the competent authorities cannot come to conclude many cases<sup>86</sup>. MAP can be accessed by the taxpayer as an individual as well as a multinational in their home country that is the country of the residency<sup>87</sup>.

### **Importance and Purpose of Mutual Tax Agreement Procedure:**

- As stated earlier the conflicting issue of double taxation can be dealt with the help of MAP procedure. Two countries often rely on the tax treaty, whose main objective is to avoid international double taxation which may occur when a particular transaction or a taxpayer is imperiled to taxation under domestic tax laws of both the countries. Due to such double taxation conflicts, it hampers the ongoing business of transfer of foreign trade and investments, technology transfer, both of which is very vital for economic growth.
- As mentioned in the previous point the main objective of a tax treaty is to avoid international double taxation by distributing tax rights equally in relation to different income categories between the taxpayer state of residence also known as the residence state and the state where applicable income is considered to arise which is also known as the source state. Going ahead,

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<sup>85</sup> Organisation for Economic Co-operation and Development Manual on Effective Mutual Agreement Procedures (MEMAP). (2007). [online] Available at: <https://www.oecd.org/ctp/38061910.pdf> [Accessed 4 Aug. 2020].

<sup>86</sup> Organisation for Economic Co-operation and Development Manual on Effective Mutual Agreement Procedures (MEMAP). (2007). [online] Available at: <https://www.oecd.org/ctp/38061910.pdf> [Accessed 4 Aug. 2020].

<sup>87</sup> Fox, R. (2017). *The Mutual Agreement Procedure: A Taxpayers' Tool Reinvented | Insights | DLA Piper Global Law Firm*. [online] DLA Piper. Available at: <https://www.dlapiper.com/en/uk/insights/publications/2017/07/the-mutual-agreement-procedure/>.

tax treaty will provide a way in which double taxation can be eradicated by the domiciled state in case, where treaty makes both states of residence and source state to levy an income tax.

- Sometimes, it may happen so that, discrepancies in international double taxation occur despite tax treaty being there between two countries. Such discrepancies occur due to one of the contracting state's improper application of the treaty or difference of opinions or views between the contracting state. In such scenarios, MAP is adopted which is on the similar ground as to procedure provided in the UN model article 25 which is the Mutual Agreement Procedure by the tax treaties to settle the problem regarding double taxation<sup>88</sup>.
- Some of the other problem faced concerning international tax disputes resolution are namely<sup>89</sup>,
  - a. Inadequate Treaty Network
  - b. Tax policies which are drawn incorrectly
  - c. Acceptance of Legal obligations
  - d. Inconsistencies in tax payer's right
  - e. The fundamental difference of opinion on tax treaty understandings
  - f. Ambiguity in the connection between domestic and international tax law.

### **Permanent establishment cases dealt within the MAP:**

As per OECD MC and analysis of this thesis as stated above, the allocation of tax jurisdiction in case of business profits is with the resident state, unless a PE has been established in the other contracting state. In this situation, the profits arising from source state are attributable to that state.

Commonly, the taxpayers use MAP where they do not support the assumption of a contracting state that their existence or operations in the state give rise to PE and hence part of their earnings are taxable in the state, similar to the situations as stated above in chapters 3 and 4. MAP aids demands are often made in linking with the assessment of the income attributable to PE. Many a time PE cases involve juridical double taxation. For instance, a company resident in state X carries on some business operations in state Y. It is not clear whether the company has a PE in state Y due to ambiguity of article 5 of the OECD MC and the unique business of the company. In such a situation the conflict arises as to profits should be attributable to the said PE or not. In the first place, the existence of PE itself is in question. In such

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<sup>88</sup> Guide to The Mutual Agreement Procedure Under Tax Treaties. (2012). [online] Available at: [https://www.un.org/esa/ffd/wp-content/uploads/2014/10/ta-Guide\\_MAP.pdf](https://www.un.org/esa/ffd/wp-content/uploads/2014/10/ta-Guide_MAP.pdf) [Accessed 5 Aug. 2020].

<sup>89</sup> Discussion Draft on Chapter 4: Special issues faced by developing countries (and LDCs in particular). (n.d.). [online] Available at: [https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-04/16STM\\_Chapter4\\_Dispute-Handbook\\_Special-Issues.pdf](https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-04/16STM_Chapter4_Dispute-Handbook_Special-Issues.pdf) [Accessed 5 Aug. 2020].

a situation the taxpayer is at great risk of double taxation. To avoid such situations and conflicts, the MAP is relevant and helpful in settling down such conflicts and thereby mitigating double taxation.

MAP is considered to be a procedure which in combination to commonly used dispute solving strategies available under the domestic law of every country. However, MAP is still not much in use despite an increase in international MAP cases. This can be because of the difficulties in legal as well as a practical approach in implementing MAP. Current reforms in the MAP process following the promises of the countries to the basic requirements set out in Action 14 BEPS Action Plan and the signing of OECD Multilateral Convention for the Implementation of tax treaty-related measures to avoid BEPS (MLI) will enhance both transparencies as well as the effectiveness of MAP. The MAP process is stated to be more used in the future as the competent authorities interact and deal closely as a result of BEPS. It is also observed that MAP related meeting and conferences are being conducted internationally and it is strengthening the bond or bilateral relations between the competent authorities.

#### **Advantages of MAP:**

- Eradication of double taxation
- MAP process can help in defining in residence country for an individual with dual residency.
- Implementing treaty restraints.
- Fortifying unbiased tax treatment<sup>90</sup>.

Hence, in the author's view and subject of this thesis, apart from the other alternatives of Arbitration and Court proceedings, MAP procedures can be followed to settle disputes between jurisdictions in the PE cases resulting from measures imposed by the countries and changing working models of businesses as discussed in chapters 3 and 4.

## **6. CONCLUSION AND RECOMMENDATIONS**

The concept of permanent establishment has been discussed at length in the above chapters. PE marks the important threshold of source taxation, as the profits generated are attributable to the source state in case of presence of PE therein. Hence, to attribute profits to a PE, in the first place it is important to identify the existence of a PE in a given jurisdiction. Chapters 2, 3, 4 and 5 therefore have critically analysed the different aspects of a Permanent Establishment. As stated in chapter 2, first the principles of international tax have been explained. It is pertinent to note that countries do not rely on any one of

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<sup>90</sup> Fox, R. (2017). *The Mutual Agreement Procedure: A Taxpayers' Tool Reinvented* | Insights | DLA Piper Global Law Firm. [online] DLA Piper. Available at: <https://www.dlapiper.com/en/uk/insights/publications/2017/07/the-mutual-agreement-procedure/>.

these specific principles, but a combination of these principles are enshrined in their domestic laws and tax treaties. Based on these principles the taxing rights are allocated to jurisdictions.

Further, a detailed analysis of the OECD model convention, 2017, clarifies the concept of permanent establishment according to the OECD guidelines. Though OECD guidelines being soft law i.e. not binding on any of its member states, most of the countries formulate their tax treaties on the OECD guidelines. Article 5 (permanent establishment) is relevant in this regard and has set a benchmark for solving and settling situations regarding existence of a PE. Article 5 enlists various examples and definition of PE, followed by exemptions and types of PE. Scrutinizing these leads to a conclusion whether a PE exists in a given jurisdiction. Based on which further profits are attributable to PE. The attribution of profits to PE not being in the scope of this thesis, it focuses on identification of PE. It is therefore clear from chapter 3 that it is important to analyse cases and test them against the said principles. It is important to consider the locus test, the tempus test, ius test, and the business activity test which can help reach a conclusion whether a certain business activity gives rise to a PE in a that jurisdiction. Overall, one must remember that not every business activity of a non-resident enterprise will result in a PE. The tax authorities have to consider if the business activity is of a temporary nature or does it have a level of permanency. The business activity carried on shall not be of a preparatory or auxiliary nature or similar to the exemptions as listed in article 5(4) of the OECD MC, 2017. Further, there are different types of PE and in general all of them have their own criteria and thresholds to be satisfied. For instance, in an agency PE, it is important identify whether an agent is a dependent or an independent agent. If an independent agent has been identified after understanding his business activities, it shall not constitute a PE as per article 5(6) of the OECD MC, 2017. In case it is a dependant agent the conditions of article 5(5) have to be satisfied so as to establish a PE in that jurisdiction. Similarly, in a construction PE, a minimum threshold of 12 months has been proposed by the OECD MC.

The after effects of the pandemic being disturbing and devastating in many aspects, have raised a few questions in relation to the topic of this thesis and other areas of taxation also. Because of the changed working styles of the businesses and the work from home concept being followed by the employees may trigger the risk of PE in different jurisdictions. Though, there is no settled principle or law or judicial precedent on this topic in the current scenario, OECD and many other tax authorities have issued guidelines in this regard. It is recommended for the businesses to maintain a strong documentation to support their contentions during this period. Further, one should not deviate from the basics of the concept of PE. Some of them being the permanency test, the business activity test. This situation of COVID 19 is temporary and the concept of work from home is derived from the directives and regulations of governments of different jurisdictions. Hence, it is not a mandate or requirement of the businesses but a necessity to follow rules and regulations of the different countries governing authorities. Hence, in the author's view this temporary changed situation and the new concept of home

office (work from home) in this regard should not trigger the concept of permanent establishment. In the author's view, it is, therefore, recommended and fair to include such temporary and abnormal situations in the list of exemptions similar to article 5(4) of the OECD MC, 2017. However, this solution of exclusion of temporary situations because of the government restrictions shall not be true in the case where an employee continues to work from home after the relaxation of such measures or where an employee has been working in that situation before the government measures were implemented. In that case the analysis and discussion in chapter 3 and 4 would be followed depending on the situation of every case accordingly. Many organisations and companies have taken leverage of the pandemic and tried to restructure their businesses and working conditions. It might be a revolution in the coming years where businesses permanently shut their huge premises and shift to working from home. In such situations the current guidelines would not be applicable and in the later conditions it might give rise to PE in that jurisdiction according to the analysis in chapter 3. As a result, the current conclusion based on the OECD guidelines and analysis of this thesis should only be applicable to a case where employees of companies are stranded in a particular jurisdiction because of the government restrictions and travel ban which would be temporary, and not as a requirement of the businesses itself. Similarly, in case of agency PE, where the dependant agent is performing his duties in a country where he might be stranded as the consequence of travel restrictions, should not create a dependant agent PE for the non-resident enterprise. It is important to interpret the concept of 'habitual' concluding of contracts continuity in such cases. Also, in the author's view, all other cases where an employee or a dependant agent is working in the given jurisdiction before or after the restrictions of COVID19, shall be examined in a different manner as discussed in chapter 3 of this thesis. The exemption or temporary exclusion should only relate for the period where restrictions were imposed in that particular country and subject to a proper record maintained by the companies of such situations

Though there is no concrete and established law in this regard, apart from the guidelines of OECD and different countries, many tax authorities have tried to provide their guidance and support on this issue. It is still possible that many disputes may arise in the future regarding the existence of PE during this pandemic COVID19. Hence, in the author's view, it is best recommended for a business to keep a strong record of documentary evidence and follow the guidelines of the concerned authorities. Because of the huge impact of this pandemic worldwide, disputes are unavoidable and it will be interesting to follow case laws in the future in relation to these circumstances.

Finally, to conclude, in chapter 5 the author has discussed the Mutual Agreement Procedure as proposed by the OECD MC, 2017, in cases of disputes to be settled in relation to PE, apart from the arbitration and the court proceedings. As stated above since there is no settled principle of law on this current situation of pandemic and though there is some guideline provided by the OECD, it is still not certain in many situations as to when things would go back to normal. Though most of the countries and OECD have stated in their guidelines that the temporary situation of working from home should not be

considered, it is still vague and has a lot of scope for interpretation. In such cases it is highly probable that the countries would end up in disputes as regard to this situation. In such cases the MAP might be one of the efficient ways to settle disputes regarding existence of PE in the author's view.

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