Technical analysis of the creation of a permanent establishment for a non-resident employer by virtue of its employees working remotely from another country

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ABSTRACT

Remote working is certainly no new phenomenon; it has only become more prevalent because of the COVID-19 pandemic. Remote working became possible with the development of the telephone, internet, laptops and smart devices, and allows employees not to be confined to their employer's workplaces.

It is widely understood that a state can only tax an enterprise if it has a PE in that state. Consequently, there is a need to examine whether a remote employee can establish a PE in a state and create a taxable presence for their employer in the host state.

A PE may exist in the form of the so-called "physical PE" if the enterprise has effective power over the place of business where the remote employee creates the product to be delivered to the client. Alternatively, in the form of a "services PE", remote employee is furnishing a service, for an extended period of time, from their host state to a client situated in another state; or an "agency PE" if that employee concludes contracts on behalf of their employer.

However, by application of a series of scenarios, it is submitted that the host state can only, in very limited circumstances tax the employer. Because of the increased and continuous mobility of a remote employee, a physical PE will not be created because a physical PE requires permanence and geographical and commercial coherency. A services PE will not be created because it requires that the services relate to the "same project or connected projects" which creates complex interpretive issues for tax authorities. Moreover, the services PE's "duration" test allows for the avoidance of a services PE: a foreign enterprise can generate substantial revenue due to the services rendered by an employee in another state within a week without creating a taxable presence. An agency PE's limited application to the conclusion of contracts neglects the fact that the source of the profits, the work which a foreign enterprise does to earn the income flowing from the conclusion of the contracts, is done by an employee who may not be present when the contract is concluded.

It is therefore submitted that the PE concept should be revisited to address these shortcomings, and the ATAF Model's services PE provision serves as a basis for a solution.

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ABBREVIATIONS AND ACRONYMS

ATAF Model (2019)	"ATAF Model Agreement for the elimination of double taxation with respect to taxes on income and the prevention of tax avoidance and evasion (2019)"
ATAF Model Commentary (2019)	"Commentary on the articles of the ATAF Model Agreement for the elimination of double taxation with respect to taxes on income and the prevention of tax avoidance and evasion (2019)"
OECD	The Organisation of Economic Co-operation and Development
OECD Commentary (2017)	Commentary to the OECD Model Tax Convention on Income and Capital (2017)
OECD Model (2017)	OECD Model Tax Convention on Income and on Capital Volume I and II (21 November 2017)
PE	Permanent establishment
UN Model (2021)	United Nations Model Double Taxation Convention between Developed and Developing Countries (2021)
UN Model Commentary (2021)	Commentaries on the articles of the United Nationals Model Double Taxation Convention between Developed and Developing Countries (2021)

TABLE OF CONTENTS

Chapter 1: Introduction ... 1

1.1 Background ... 1

1.2 Problem Statement ... 2

1.3 Main Research Objective ... 3

1.4 Research Method ... 4

1.5 Limitation of Scope ... 5

1.6 Structure of the dissertation ... 5

Chapter 2: International tax framework and rationale for the PE Nexus ... 6

2.1 Introduction ... 6

2.1.1 Residence based taxation ... 7

2.1.2 Source-based taxation ... 7

2.2. A brief historical overview of the allocation of taxing rights ... 9

2.3. Theoretical foundations and rationale for source-based taxation ... 12

2.3.1 Benefit Theory ... 13

2.3.2 Neutrality Theory ... 15

2.3.4 Entitlement Theory ... 17

2.4 Conclusion ... 18

Chapter 3: Application of the PE Nexus to The Remote Working Area ... 19

3.1 Introduction ... 19

3.2. The definition of PE in Article 5 ... 20

3.2.1 Physical PE ... 20

3.2.1.1 The existence of a place of business ... 21

3.2.1.2 The fixedness of the place of business ... 21

3.2.1.3 At the disposal of or right of use ... 24

3.2.1.4 Through which the business is carried on ... 28

3.2.2 Services PE ... 29

3.2.3 Agency PE 37
3.2.3.1 Act on behalf of the enterprise 38
3.2.3.2 Concludes contracts or plays the principal role 38
3.2.3.3 The relevant contracts 39
3.2.3.4 Habitually 40
3.2.3.5 Independent agent 41
3.3 Application of traditional source rules to remote working 41
3.3.1 Illustration 1 41
3.3.2 Illustration 2 42
3.3.3 Illustration 3 42
3.4 Difficulties in application to the abovementioned illustrations 42
3.4.1 Physical PE 42
3.4.2 Services PE 47
3.4.3 Agency PE 49
3.5 Conclusion 49
Chapter 4: Conclusion 51
4.1 Concluding remarks 51
4.2 Recommendation 52
BIBLIOGRAPHY 54

CHAPTER 1: INTRODUCTION

1.1 Background

"Remote working" is certainly no new concept or phenomenon.[1] A term interchangeably used with "teleworking" and "telecommuting", yet distinguishable,[2] describes the activity to work on a full-time basis from a location other than the office.[3] Working from home is regarded as remote or teleworking,[4] depending on how often you are working from a location other than the office. "Teleworking" describes the situation where an employee is working from a location near the employer's office every other day. "Telecommuting", originally coined by Jack Niles, a NASA engineer in 1972,[5] refers to an employment arrangement where employees work from home or at another location. Effectively employees do not have to travel or commute to the office to render their employment services.[6]

For years, these flexible working arrangements were only considered in an in-country context, where an employee works from home to avoid traveling to the city. However, with the advancement of technology, mobile telephones, email, instant messaging, file sharing systems, and online video chat, remote working in the cross-border context may become the norm.

As seen during the COVID-19 global pandemic, many employees (expatriates and secondees alike) temporarily "left their country of employment (initially at least) and decided to return to their country of residence to be with their families as the pandemic accelerated" [7] and continued working for their employer companies (the enterprise) during the pandemic.[8]

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[1] D. Reisinger, How The Work From Home Revolution Is Remaking Many Different Economies, (July 2020).
[2] https://www.webopedia.com/TERM/T/teleworking.html
[3] Ibid.
[4] https://app.croneri.co.uk/topics/homeworking-and-teleworking/indepth
[5] Allied Telecom, *The History of Telecommuting*, (January 2016), https://www.alliedtelecom.net/the-history-of-telecommuting/ (accessed 21 April 2021).
[6] https://www.thebalancecareers.com/what-is-telecommuting-2062113 (accessed 21 April 2021).
[7] https://www.who.int/emergencies/diseases/novel-coronavirus-2019/interactive-timeline/#event-71 (accessed 17 October 2020).
[8] Interestingly, the Barbados Government, to address the adverse implications of the COVID-19 pandemic on Barbados tourism, offers a special visa that allows corporate teams or individuals to work remotely from the island for up to a year while vacationing. Similarly, Dubai also offers visas to work

According to a recent survey conducted by Iometrics and Global Workplace Analytics, 74% of participating CFOs say their company will reduce their current office space as employees have adapted to working from home.[9] 88% of office workers work from home more than one day a week, and 68% say they are very successful working from home.[10] "Almost 50% of the total time spent commuting to the office, and back is avoided when working from home, and the time saved is usually spent working."[11]

Remote working is not possible for all employees due to the very nature of some occupations—for instance, personal service workers, sales workers, factory workers, health workers, etc. Remote working is more prevalent in the services industry among the legal and other professional services, IT and communication services, and knowledge-intensive business services.[12]

1.2 Problem statement

The accelerated increase in remote working and the continuous advances in information and communication technology have dramatically changed flexible working arrangements for organisations and employees alike. The business of the enterprise, particularly the business of the service industry enterprises, can be conducted from any place and is no longer limited to the place of work of the enterprise alone. An employee's workplace is no longer confined to the enterprise's workplace but may be located at any location that can accommodate them and their laptops.

Moreover, enterprises can source top talent from foreign countries without having the employee relocate to the enterprise's state of residence. However, with the rise of remote-work permits, the demand for remote working arrangements of expatriates and the changing workplace of an employee are all posing challenges to cross-border taxation of non-resident enterprises.

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remotely from the United Arab Emirates. See https://barbadoswelcomestamp.bb/wp-content/uploads/2020/07/12-Month-Barbados-Welcome-Stamp-Visa-Press-Release-Final.pdf; and https://www.visitdubai.com/en/sc7/travel-planning/travel-tools/work-remotely-in-dubai.

[9] Iometrics & Global Workplace Analytics, *Global Work From Home Experience Survey Report* (May 2020) at 73.

[10] Iometrics et al. *supra* n. 9 at 69.

[11] Iometrics et al. *supra* n. 9 at 43.

[12] S.Milasi et al., Telework in the EU before and after the COVID-19: where we were, where we head to, European Commission Joint Research Centre at pages 1 – 2.

Integral to the source state's taxing jurisdiction is the existence of a PE in that state. Without it, "the source state will not be entitled to tax the enterprise on its business profits". [13]

As was quoted in the unreported case of *L.J. Downing vs SIR*:[14]

> "It has come to be accepted in international fiscal matters that until an enterprise of one State sets up a PE in another State it should not properly be regarded as participating in the economic life of that other State to such an extent that it comes within the jurisdiction of that other State's taxing rights."

The current definition of PEs requires "*a fixed place of business through which the business of an enterprise is wholly or partly carried on*".[15] The business of the enterprise, particularly the business of the service industry enterprises, can be conducted from any place and is no longer limited to the place of work of the enterprise alone. The advancements in technology enable enterprises to source talented employees working from remote locations who render services and/or deliver goods to customers worldwide.

This dissertation will focus on how the development of technology and the aftermath of the global pandemic have encouraged remote working and the challenges faced in applying the PE principle.

1.3 Main Research Objective

This dissertation aims to assess whether the PE concept can serve as the nexus to establish the taxation of businesses with a remote workforce. Considerations include whether an enterprise could not be liable for tax despite having a business presence in a State and the application of source rules with respect to worldwide income from enterprises.

The following specific objectives will guide the study, firstly to critically analyse Article 5 of the OECD Model Convention, UN Model Convention, and ATAF Model

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[13] B.J. Arnold, Article 5: Permanent Establishment - Global Tax Treaty Commentary, Global Topics IBFD (accessed 22 April 2021) at 1.1.1.1.
[14] *L.J. Downing v. SIR*, Natal Income Tax Special Court, 27 October 1972, case number 6737.
[15] S.V. Kostić, *A Plea for a Workforce Presence PE Concept in a Post-Covid Ditigalized World,* 49 Intertax 10, (2021).

Convention and its supporting Commentary in the context of enterprises with remote workforces to establish the inclusion, exclusions, and limitations of this definition.

1.4 The Research Method

The dissertation applies a doctrinal research method which entails a literature review of and reference to international tax conventions and their Commentary, published articles, textbooks, and judicial case law. An analytical approach is followed whereby one will start by observing the PE concept as provided by the OECD, UN, and ATAF Model Conventions as further explained by the Commentary and followed by analysing whether the concept can be applied to enterprises with a remote workforce.

1.5 Limitations of Scope

The dissertation specifically excludes any consideration of the labour law of any country that may change the status of employees working remotely.

The analysis will be based on the assumption that employees are under remote working arrangements.

1.6 Structure of the Dissertation

This dissertation consists of four chapters.

This introductory chapter provides an overview of the research paper and its objectives. It addresses the background and states the problem, the methodology, and the objectives of the study.

The second chapter addresses the principles that set the framework for international taxation and the rationale for source taxation, which justifies the taxation of a PE in any jurisdiction.

Chapter three discusses the PE concept provided under the OECD and UN Model. This chapter explains the PE concept, what it is, and how it is applied to business profits. It further discusses how the PE concept could be applied in a remote working environment, including a discussion on the criteria required for a PE concept to apply and whether such criteria should be applied in relation to a remote working environment.

Chapter four provides the conclusions of the research.

CHAPTER 2: THE INTERNATIONAL TAX FRAMEWORK AND RATIONALE FOR THE PE NEXUS

2.1 Introduction

A key consideration when contemplating whether a State may tax income is the connection or nexus between the income and the State. Accordingly, the workforce of a foreign enterprise could possibly serve as the connection that the State has with the business income for that State to levy tax.

Various States have laid down in their domestic laws the requiring factors which establish the necessary connection enabling the State to tax the income.[16] It is standard practice that a State asserts its claim to tax based on the person who receives the income being connected to that State (i.e. the residence-based taxation) or the activities giving rise to the income are connected to that State (i.e. the source-based taxation).[17] While there are variations within the residence basis of taxation (being domicile, citizenship, or nationality), tax sovereignty – a Sate having sole jurisdiction over its territory or subjects – depends on the nexus established between a State and its subjects.[18]

It is commonly understood amongst scholars that "*[o]nly when this qualifying connection is established, the exercise of tax-imposing and tax-collecting powers of the state shall be lawful. With regards to income tax, the connection must be established either with regard to the person of the taxpayer (person who is obliged to pay certain amount of tax under the domestic tax law of the state) or with regard to the facts contributing to the derivation of income, as the taxable object. The requirement for a qualifying connection or a nexus has been thusly framed by Klaus Vogel:*

[16] L. Olivier and M. Honiball, *International Tax: A South African Perspective*, 5th ed. (SiberInk, 2011).
[17] S. Gadžo, *The Principle of 'Nexus' or 'Genuine Link' as a Keystone of International Income Tax Law: A Reappraisal*, 46 Intertax 3, at 1 (2018).
[18] M. Lang, 1. The problem of double taxation in Introduction to the Law of Double Taxation Conventions (Third Edition) (IBFD 2021), Books IBFD. See also OECD/G20, *Addressing the Tax Challenges of the Digital Economy – Action 1: 2014 Deliverable,* OECD/G20 Base Erosion and Shifting Project, (OECD 2014).

'(C)urrent international law permits taxation of foreign economic transactions when a sufficient connection exists between the taxpayer and the taxing State.'"[19]

Accordingly, a state's authority to tax its subjects is determined in accordance with a "genuine link" that it has with each subject present in that state.

2.1.1 Residence-Based Taxation

According to the residence principle, a state's right to tax income depends on whether the taxpayer is a resident of the state that wishes to exercise its tax-imposing and tax-collecting powers. If a person is a resident of a particular state, they have a nexus with that state, which provides that state with jurisdiction to tax the resident person on its worldwide income.[20] A residence basis of taxation is justified because the resident taxpayer "enjoys the protection of the state and should therefore contribute to the cost of the government of the state in which they reside".[21]

For double tax conventions to successfully be applied to avoid double taxation, it is important that a taxpayer is a resident of either of the two contracting states to claim the benefits under the convention. Still, the taxing rights of residence states are favoured.

2.1.2 Source-Based Taxation

According to Vogel, "source" "refers to a state that in some way or other is connected to the production of the income in question, to the state where value is added to a good. In contrast, the type of connection that establishes that source of income cannot be defined generally".[22] Under the source principle, a state's right to tax income depends on whether a taxpayer's work to earn an income is performed within the state's borders.[23] The justification for the source principle is that both residents and non-residents can be expected to share in the costs of the state's infrastructure and

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[19] S. Gadžo, *Acknowledgements in Nexus Requirements for Taxation of Non-Residents' Business Income – A Normative Evaluation in the Context of the Global Economy* (IBFD 2018), Books IBFD at 2.2.4.
[20] M. Kobesty, *International Taxation of PEs: Principles and Policy* at 12 (J. Tiley, 2011), Cambridge Tax Law Series.
[21] Olivier and Honiball, *supra* n. 16, at page 19.
[22] K. Vogel, *Worldwide vs. source taxation of income – A review and re-evaluation of arguments (Part I),* Intertax 8 (1988) at 216 – 229.
[23] Olivier and Honiball, *supra* n. 16, at page 11.

running, which makes the production of income and investment through its consumption possible.[24] This corresponds with the Benefit Theory.[25]

However, while the "doctrine has demonstrated that the source state should have the primary right to tax over the residence state, traditionally the residence state has better taxing rights, as is reflected by double tax conventions".[26] With business income, it is well-founded that a state should not tax the business income of an enterprise of another state until the enterprise has a PE in that state.[27] In this regard, the source is limited by the existence of a PE as the minimum requirement for source taxation under the model tax conventions.[28] As opposed to having the right to tax income on the basis that the enterprise performed work in the state that gave rise to business income, a source state's right to tax is limited to only tax the income of a foreign enterprise that has a PE in the source state. Therefore, it is important to identify if a PE exists. However, given the advancements in technology, can the source of the profits of an enterprise with a remote workforce still be established? In Kemmeren's view, "it is true that only individuals can create income and that things in themselves cannot. The intellectual element is the key component in the production of income." Through the action of an individual, whether a device is used, value may be added to things. The (key) "intellectual element in digital service, e.g. the advice of a tax lawyer, is [in Kemmeren's view] found in the state where the tax lawyer prepared his advice."[29]

In that author's view, the intellectual element in the production of income is of more importance more than ever in justifying source-based taxation of the profits of an enterprise with a remote workforce.

2.2 A brief historical overview of the allocation of taxing rights

The origin of allocating taxing rights under double tax agreements can be found in the early 1920s. Specifically, the League of Nations appointed four economists to examine the issue of double taxation and to establish a theoretical basis for the principles upon

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[24] Ibid, at page 11.
[25] G. S. Cooper, *The Benefit Theory of Taxation*, 11 Austl. Tax F. 397 (1994).
[26] E.C.C.M. Kemmeren, *Source of Income in Globalizing Economies: Overview of the issues and a plea for an origin-based approach,* Bull. Intl. Taxn. (2006) 430 - 452.
[27] Paragraph 11 of the OECD Commentary (2017) to Article 7.
[28] D. Pinto, *The Need to Reconceptualize the PE Threshold,* 60 Bull. Intl. Taxn. 7, at 1, (2006), Journals IBFD.
[29] Kemmeren, *supra,* n. 26 at p. 14.

which the avoidance of double taxation should be founded.[30] There was a prevailing opinion on Source-State versus Residence-State taxation as expressed through the works of von Schanz and Seligman.[31] These scholars' views were based on the opinion that income should be taxed in accordance with the "economic allegiance" of the taxable subjects or objects as opposed to the political allegiance of the subject.[32] "*The state in which the income had "origin" would represent the state to which the income had the strongest economic allegiance, and the state of "situs" represented the strongest allegiance of property.*"[33]

While "economic allegiance" still formed the basis of a state's taxing jurisdiction, the four Economists, who were tasked with establishing the theoretical basis, redefined the substance of the term "economic allegiance". The doctrine of "economic allegiance", based on the faculty of the individual or his ability to pay, as encapsulated by, perhaps, one of the most important passages from the 1923 Economists Report:[34]

> "*Practically, therefore, apart from the question of nationality, which still plays a minor role, the choice lies between the principle of domicile and that of location or origin. Taking the field of taxation as a whole, the reason why tax authorities waver between these two principles is that each may be considered as part of the still broader principle of economic interest or economic allegiance, as against the doctrine of political allegiance. A part of the total sum paid according to the ability of a person ought to reach the competing authorities according to his economic interest under each authority. The ideal solution is that the individual's whole faculty should be taxed, but that it should be taxed only once, and that the liability should be divided among the tax districts according to his relative interests in each. The individual has certain economic interests in his place of his permanent residence or domicile, as well as in the place or places*

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[30] OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/9789264241046-en at 2.3.2.1.

[31] A. Skaar, *PE: Erosion of a Tax Treaty Principle* at 7.4.3 (2020), Wolters Kluwer.

[32] Ibid.

[33] Ibid.

[34] The Report on Double Taxation submitted to the Financial Committee Economic and Financial Commission Report by the Experts on Double Taxation Document E.F.S.73.F.19 (5 April 1923) ("The 1923 Economists Report) at p. 20 [4024].

where his property is situated or from which his income is derived. If he makes money in one place he generally spends it in another."

The above passage aims to measure "the economic relationships between the country and the income or the person taxed",[35] which corresponds with the principles above of source-based taxation and residence-based taxation. "The four Economists identified four features comprising economic allegiance:

(i) the place of origin of the wealth;

(ii) the place of the *situs* or location of wealth or income;

(iii) the principle of legal rights to the place of enforcement of the rights to wealth;

(iv) the principle of consumption or appropriation of disposition to the place of residence or domicile."[36]

From these four factors, two factors were considered more important: "the origin of the wealth or income and the residence or domicile of the person entitled to consume the wealth or income."[37] To this end, it is important to distinguish between origin and *situs,* where the economic distinction is between income and capital.[38] Situs refers to the location of the assets, whereas origin refers to the location of the source of income.

With the theoretical basis provided by the four Economists, the League of Nations proceeded with a report elaborating on the technical principles for the avoidance of double taxation. This report, submitted in 1925, supported the principles submitted in the 1923 report.[39] The resolutions to the avoidance of double taxation adopted supported the shift towards residence state taxation:[40]

"*In order to avoid double taxation, the best means would be to accept residence as a basis of the tax on income. They [the Committee] recognise, however, that the application of this principle could not be expected completely to preclude all*

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[35] OECD, *supra* n. 30, at p. 14.
[36] The 1923 Economists Report, *supra* n.34, p.15.
[37] OECD, *supra* n. 30, p.14.
[38] The 1923 Economists Report, *supra* n.34, p.15.
[39] League of Nations: Technical Experts to the Economic and Financial Committee Double Taxation and Tax Evasion Report and Resolutions submitted by the Technical Experts to the Financial Committee Document F.212 (February 1925) ("the 1925 Technical Experts Report").
[40] Ibid.

taxation according to its origin of income derived from landed property or even from commercial or industrial enterprises.

In all cases, without exception, where taxation according to origin cannot be avoided, the Committee consider that a distinction must be made between taxes affecting income at its origin and those which affect the taxpayer by reason of his residence and are charged on his entire income. They consider it essential that the country of origin should confine itself to taxing incomes accrued within its territory by a tax at the source, at the same time strictly limiting this taxation.

It follows from the above that the country of origin is not entitled to require from the non-resident taxpayer declarations covering any composite part of his income, no matter what its origin may be."

After that, the treaties introduced were based on a system that allowed source-taxation of particular investments or embodiments of wealth.[41]

As far as income from commercial or industrial activities was concerned, which is more relevant for purposes of this paper, source-state taxation was accepted if the enterprise had "a branch, an agency, an establishment, a stable commercial or industrial organisation, or a permanent representative"[42] there. This was the first attempt by the League of Nations to define the PE concept in 1925.[43]

In 1927 the League of Nations introduced the first draft tax convention. While the International Chamber of Commerce supported the PE concept, it made an important reservation with respect to the inclusion of a "permanent representative" as a PE.[44] The Chamber recognised "that agencies established on commission were not an integral part of an enterprise and therefore drew the general distinction between dependent and independent agents as introduced in the first draft tax convention."[45]

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[41] Ibid.
[42] League of Nations, Double Taxation and Tax Evasion, Technical Experts 31 (1925).
[43] Skaar, *supra* n. 31.
[44] Ibid.
[45] Ibid.

Since the 1927 draft tax convention was not broad in scope, the League of Nations considered further developments through its Fiscal Committee.[46] The most notable models of all the draft model conventions prepared between 1928 and 1963 when the OECD prepared its first draft model convention were the Mexico and London model conventions.[47]

As recognised from the above, the source is limited by the existence of a PE that measures the nexus, the genuine link, between the state and the taxable subjects.

2.3 Theoretical foundations and rationale for source-based taxation

In the previous section, it was established that a state's nexus to the business income of a foreign enterprise is where the income-generating activity of that business income is situated, i.e. the source. However, a source state's right to tax the business income of a foreign enterprise is limited, where a tax treaty exists, by the PE definition. This section of the study deals with the theories that substantiate source taxation and how those theories still apply to enterprises with a remote workforce.

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[46] K. Holmes, Chapter 3: *Double Tax Treaties in International Tax Policy and Double Tax Treaties* – An Introduction to Principles and Application (Second Revised Edition) (IBFD 2014), Books IBFD (accessed 15 October 2020). at 3.4.1.
[47] Ibid..

2.3.1 Benefit theory

According to the benefit theory, the rationale for a source state's right to tax "rests on the totality of benefits and state services provided to taxpayers that interact with a country". [48] Therefore, taxes are the reciprocal consideration for services provided.[49]

These "benefits" include education (which provides for a skilled labour force), police, fire, and defence protection which are more general benefits.[50] More "specific benefits include a conducive and operational legal infrastructure for the proper functioning of business"[51], or for enterprises with a remote workforce working from the source country, "government policies, such as keeping exchange rates stable and interest rates law, thereby providing economic stability business and consumer confidence".[52]

Cooper argues that a taxpayer's obligation to pay for these benefits arises from the terms of the social contract. He further notes that "since the terms of the social contract required the government to perform various tasks (such as protecting life or property) and individuals were obliged to fund those services, the extent that individuals benefited from those contracted services determined their liability to tax".[53]

Globalisation and the increased mobilisation of individuals have made it relatively easy for enterprises to sell their professional services in State A that is rendered through employees in State B consumed in State C. Thereby, these enterprises enjoy the benefits in various states. For this reason, one questions whether source states should only be allowed to tax non-resident enterprises' income when they have a PE in the source states. Thus, Kemmeren views that "from a theoretical perspective, the requirement of sufficient economic relationship as a consequence of the direct benefit principle, and thus also the faculty principle, implies that an occasional activity is not enough to establish a sufficient relationship with a state, despite the fact that an occasional activity could create an economic relationship with a state".[54]

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[48] Pinto, *supra* n. 28 at 2.1.
[49] Pinto, *supra* n. 28 at 2.1.
[50] Ibid.
[51] Ibid.provide
[52] Ibid.
[53] Cooper, *supra,* n. 25 p. 7.
[54] Kemmeren, *supra,* n. 26 p.14.

Pinto questions Kemmeren's argument on two grounds: firstly, with reference to Skaar's view that in line with the benefit theory of taxation, a business should still make a contribution to the source state because it still substantially benefit from the source country's infrastructure even if it does not have a physical presence in that country.[55] He notes Skaar's view that:

> *A [PE] is merely a piece of evidence of economic allegiance, not the reason for source-taxation. … that requires all enterprises which obtain such benefits from a country to render a corresponding contribution to this society, whether or not they have a (PE).*[56]

Secondly, Pinto notes that "source states provide significant benefits to foreign enterprises that carry on business activities with source states, even when there is no physical presence."[57] It is submitted that foreign enterprises with a remote workforce in the source state would not have employees and other personnel in the source state that do not have the required infrastructure to host those employees. Providing such benefits support the case for source-based taxation under the benefit theory of foreign enterprises with a remote workforce in the source states.

It is submitted that taxation of a foreign enterprise with a remote workforce in the source state – based on the benefit theory – would, as a minimum, require physical presence of the foreign enterprise's employees and/or other personnel. Two grounds support this argument: First, McLure contends that under the benefit theory in the traditional context "suggests that physical presence may be needed to establish a tax nexus for source-based taxation".[58] Secondly, as Kemmeren argues, the key intellectual element in producing income, human activities, the origin of income, must be physically present to justify source-based taxation. An employee of a non-resident enterprise establishes that physical presence, and they perform the work for the enterprise to earn the income. Moreover, an enterprise would not allow an employee to work remotely from another state that did not have a suitable telecommunications infrastructure or employ an international employee from a state whose population

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[55] Pinto, *supra,* n. 28 at p. 14.
[56] A.A. Skaar, *PE: Erosion of a Tax Treaty Principle* (1991), at 559 – 560.
[57] Pinto, *supra,* n. 28 at p. 14.
[58] Ibid.

lacks competency in computers. The provision of these benefits supports the case for source-based taxation under the benefit theory, for enterprises with remote employees or workforce, even when there is no fixed place of business.

Taking all the above arguments advanced by scholars into account under the benefit theory source-based taxation in the remote working context of foreign enterprises with limited presence of a remote workforce in the source state is justified.

2.3.2 Neutrality theory

The concept of neutrality is an economic concept based on the "decision-making of economic actors. A tax or tax provision can be neutral if it does not influence the decisions of a person to act in a specific manner."[59] Put differently, tax considerations should not influence an investor's decision on where to invest but should be determined by other factors.

In the international context, neutrality is considered on two dimensions, first recognised by Richard Musgrave: "capital export neutrality" and "capital import neutrality".[60] He defines the terms:

> *"export neutrality means that the investor should pay the same total (domestic plus foreign) tax, whether he receives a given investment income from foreign or from domestic sources. … Import neutrality means that capital funds originating in various countries should compete at equal terms in the capital market of any country."*[61]

Schön describes capital export neutrality as being that an investor's choice between domestic and foreign investment should not be distorted by the fact that the rate of tax in one state is higher than the other state, and capital import neutrality as being that there should be equal treatment by a state which hosts the investment regardless of whether the investor is domestic or foreign.[62] "Based on these definitions, capital import neutrality implies a system of worldwide taxation with a foreign tax credit. In

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[59] W. Schön, *Neutrality and Territoriality – Competing or Converging Concepts in European Tax Law?* Bulletin for International Taxation April/May 2015, 271 – 293.
[60] K. Vogel, *Worldwide vs. source taxation of income – A review and re-evaluation of arguments (Part II)* (1988) 10 Intertax, 310 - 320.
[61] Ibid.
[62] W. Schön, *International Tax Coordination for a Second-Best World (Part I)* (October 2009), World Tax Journal, 67 – 114.

contrast, capital export neutrality implies a system of source-based taxation or one which exempts foreign income".[63]

Pinto notes that based on "international competitive considerations, preference should be given to capital import neutrality rather than capital export neutrality, therefore favouring source-based taxation."[64] Moreover, he notes that capital export neutrality has been challenged before even though there is a preference for it in literature.[65]

The following observation by Kemmeren gives support to the above argument:

> "*From the perspective of an optimal allocation of the production factors, investments should be made where production is the cheapest, and the production should be done by the person who can do so most cheaply. In globalizing economies, CLIN fosters efficiency; a CLEN-based system does not. Business competes with business, not owners with owners. The real trade-off is whether the activity will be carried on by a foreign based firm or a domestic-based firm. CLIN supports an origin-based interpretation of the term "source".* [66]

His observation is based on his view that the factor of labour should supplement the traditional use of capital export and import neutrality. He notes that "since individuals can only create income, things in themselves cannot. Therefore, an individual's production factor of labour should not be ignored in assessing tax neutrality."[67] Accordingly, Kemmeren defines the concepts of tax neutrality supplemented by the production factor or labour as follows:

> *"Capital and labour export-neutrality (CLEN) is then defined as follows: an income recipient should pay the same total (domestic plus foreign) tax irrespective of whether he derives a given amount of labour or investment income from foreign or from domestic sources. The definition of capital and labour import neutrality (CLIN) should then be: labour and capital funds originating in various states should compete on equal terms in the labour and*

[63] Vogel, *supra,* n. 22 p.7.
[64] D. Pinto, *E-Commerce and Source-Based Income Taxation,* Books IBFD.
[65] D. Pinto, *E-Commerce and Source-Based Income Taxation,* Books IBFD.
[66] Kemmeren, *supra,* n. 26, p. 14.
[67] Kemmeren, *supra,* n. 26, p. 14.

> *capital markets of a state irrespective of the place of residence of the worker or investor. This way, the role of individuals in economics is valued (more) equally to its relevance."*

Against the preceding analysis, the author argues that source-based taxation is justified notwithstanding the foreign enterprise's presence limited by its workforce in the source state alone. Source-based taxation ensures that both the resident enterprises and foreign enterprises are subject to the same tax in respect of income sourced by the activities of employees of the enterprises in that state.

2.3.3 Entitlement theory

The entitlement theory is based on the view that a source state is entitled to tax the income that arises within its geographical borders.[68] Peggy Musgrave contends "that the source state is entitled to tax income originating within its borders because it is the source state as the 'place of income-generating activity' rather than the state where the income producer resides".[69] The source state should be compensated for its contribution.[70]

Kemmeren states that an "individual's intellectual element is the key component in the production of income".[71]

Based on the above observations, it is submitted that the source state should be allowed to tax income arising within its state on the basis that employees and other personnel of foreign enterprises furnish professional services remotely from the source state. The fact that the foreign enterprise may have had merely employees or other personnel performing income-generating activities without a fixed place of business does not justify limiting a source state's right to tax income originating within its geographical borders. "Musgrave further argues that according to the entitlement theory, the source state is entitled to tax income originating within its territory since the

[68] Pinto, *supra,* n.65, p.22.
[69] Richard Musgrave and Peggy Musgrave, "Inter-Nation Equity" in Modern Fiscal Issues: Essays in Honor of Carl S. Shoup (1972), p. 71, cited in Richard Doernberg and Luc Hinnekens, Electronic Commerce and International Taxation (1999), p. 306 (note 641).
[70] Ibid.
[71] Kemmeren, *supra,* n. 26, p.14.

countries where customers reside provide services that complement the consumption of their residents."[72]

2.4 Conclusion

It is evident that there is a foundation for justifying source-based taxation on a foreign enterprise. Moreover, it emphasizes the general principle of tax sovereignty, that a connection or nexus must exist between a state and its subjects, whether linked by residence, citizenship, or income as the taxable object. Economic allegiance, which forms the basis of a state's taxing jurisdiction, is physical presence within that state. Accordingly, a foreign enterprise's workforce (personnel and employees) may form the nexus or connection that establishes a taxable presence for the foreign enterprise.

As can be seen from the arguments presented, the theoretical foundations remain relevant in the justification of source-based taxation of the profits of foreign enterprises with remote workforces situated within the source states.

The following chapter analyses how "source" is defined under the PE concept for the OECD, UN and ATAF Models in the next chapter.

[72] Ibid.

CHAPTER 3: APPLICATION OF THE PE NEXUS TO THE REMOTE WORKING AREA

3.1 Introduction

It is clear that in the international tax context, there is “a long history [that] reflects the international consensus that, as a general rule, until an enterprise of one State has a permanent establishment in another State, it should not properly be regarded as participating in the economic life of that other State to such an extent that the other State should have taxing rights on its profits”.[73] While source-based taxation by a source state that is hosting the employees or other personnel of a foreign enterprise is justified as argued in the previous chapter, the ‘source’ (i.e. the place of the income-generating activity) of the profits of the foreign enterprise is limited to it having a PE in that source state.

In terms of Article 7 of the OECD Model, UN Model, and ATAF Model, “the profits of an enterprise of a Contracting State shall be taxable only in that state unless the enterprise carries on business in the other Contracting State through a PE situated therein”. Article 5 of these respective models defines PE as “a fixed place of business through which the business of an enterprise is wholly or partly carried on”.

Therefore, the PE concept is an essential requirement to be proven by the source state, which hosts a remote workforce of a foreign enterprise before the foreign enterprise’s business profits may be taxed by the source state.

This chapter will analyse whether the current PE nexus framework, as provided for in the OECD Model, UN Model, and ATAF Model, is sufficient to establish a taxable presence for foreign enterprises due to the presence of its remote workforce.

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[73] Paragraph 11 of the OECD Commentary (2017) on Article 7.

3.2 The definition of PE in Article 5

Under Article 5 of the respective models, a PE may exist for a foreign enterprise in the form of a so-called “physical PE” if a foreign enterprise has a physical presence in the state in some way or form, or a “services-” or “agency PE”, which may be present due to the presence of a foreign enterprise’s workforce in that state. The author analyses each of these PE types.

3.2.1 Physical PE

The term “PE” is defined in Article 5(1) of the OECD Model and means “a fixed place of business through which the business of an enterprise is wholly or partly carried on”.[74] The OECD Commentary (2017) distinguishes between three main conditions for a PE:

- “the existence of a ‘place of business’, i.e. a facility such as premises or, in certain instances, machinery or equipment;
- this place of business must be ‘fixed’, i.e. it must be established at a distinct place with a certain degree of permanence;
- the carrying on of the enterprise's business through this fixed place of business, which usually means that persons who, in one way or another, are dependent on the enterprise (personnel) conduct the enterprise's business in the state in which the fixed place is situated”.[75]

The conditions for a physical PE can further be analysed through the following requirements:

- the existence of a place of business;
- that is fixed;
- which is at the disposal of the enterprise or which it has a certain right of use over; and
- through which the enterprise's business is carried on (the business connection test).

[74] The term is similarly defined in Article 5(1) of the UN Model and ATAF Model, respectively.
[75] Paragraph 6 of the OECD Commentary (2017) on Article 5(1).

3.2.1.1 Existence of a place of business

Neither the OECD Model nor the UN Model defines the term "place of business". Both the OECD Commentary (2017) and UN Commentary (2021) consider the term to have a broad meaning, which includes "any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose".[76] However, it is recognised "that a 'place of business' may also exist where no premises are available or required for carrying on the enterprise's business, and it simply has a certain amount of space at its disposal."[77] This indeed suggests that a place of business may exist in a foreign state where an individual travels abroad to the foreign state for a few months to complete their postgraduate studies, remains in part-time employment with an employer resident in their state of residence, and works remotely for that employer whether they are working from a rented apartment, the library of the foreign tertiary institution, a shared office space, or coffee shop in the source state.

3.2.1.2 The fixedness of the place of business

The OECD Commentary (2017) and UN Commentary note that a place of business must be 'fixed', "which means there has to be a link between the place of business and a specific geographical point."[78] This requirement for a specific geographical point seems uncontroversial and relatively straightforward when one is working in an office.

However, it is more problematic when an employee works remotely from various geographical points, whether in the same state or not. Consider an individual employed as a full-time remote employee who travels the world, similar to a digital nomad. A single geographical point is identified when the employee returns to the same hotel room or hotel office to work but may be working on various projects or assignments. What about an employee that travels within the same state but does not remain at the same location? The OECD Commentary (2017) and UN Commentary (2017) notes the issue and suggests that where the activities of an enterprise are often moved between places, a single place of business exists where in light of the nature

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[76] Paragraph 10 of the OECD Commentary (2017) on Article 5(1). Paragraph 4 of the UN Commentary (2017) on Article 5(1).
[77] Ibid.
[78] Paragraph 21 of the OECD Commentary (2017) on Article 5(1). Paragraph 5 of the UN Commentary (2017) on Article 5(1).

of the business, a particular location is identified as constituting a coherent whole commercially and geographically.[79] Some of the examples given by the OECD Commentary (2017) include a large mine; a hotel of offices "in which a consulting firm regularly rents different offices";[80] a consultant that works in several different offices within the same branch of the customer and within the same location;[81] "a stand at an outdoor market or fair in different parts of which a trader regularly sets up his stand".[82]

From these examples, one can infer that geographic coherency requires that business activities are carried out at a single place or location. Commercial coherency is achieved when the business activities are performed under a single contract.

As Vogel explains it, "a PE can be deemed to exist only if the place of business has a certain degree of permanency, i.e. if it is not of a purely temporary nature."[83] The OECD Commentary (2017) "notes that a period of 6 months indicates permanency".[84] However, a short period may apply, and the fulfilment of the requirement may vary, depending on the nature of the business activities carried on and the intent of the enterprise.[85]

The OECD Commentary (2017) recognises two exceptions. Firstly, where the activities are recurring, "each time the place is used is considered in combination with the number of times during which that place is used."[86] In other words, if a place of business is used time and time again, one should consider how many times a place of business is being used.

Currently, there is no settled authority in case law on the amount of time required that is indicative of permanency, which led to a controversial conclusion in Formula One World Championship Ltd v Commissioner of Income Tax[87] by the Supreme Court of

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[79] Paragraph 22 of the OECD Commentary (2017) on Article 5(1). See also, paragraph 5.1 of the UN Commentary (2017) on Article 5(1).
[80] Paragraph 23 of the OECD Commentary (2017) on Article 5(1).
[81] Paragraph 25 of the OECD Commentary (2017) on Article 5(1).
[82] Paragraph 23 of the OECD Commentary (2017) on Article 5(1).
[83] Klaus Vogel on Double Taxation Conventions, 4th Edition, Art.5, para. 65, p. 346 (Kluwer Law International 2015).
[84] Paragraph 28 of the OECD Model Commentary (2017) on Article 5.
[85] B.R. Obuoforibo et al., List of Contributors in *Roy Rohatgi on International Taxation: Volume 1 Principles* (O. Ostaszewska & B.R. Obuoforibo eds., IBFD 2018), Books IBFD at 11.1.1.1.
[86] Paragraph 29 of the OECD Commentary (2017) on Article 5(1).
[87] *Formula One World Championship Ltd v Commissioner of Income Tax* (Civil Appeal No. 3849 of 2017).

India that heavily relied on the OECD Commentary (2017). One of the main arguments advanced by the taxpayer was that the possession of a place for three days could not be regarded as a PE.[88] In response, the Supreme Court of India remarked that "appellants are trying to trivialize the issue by harping on the fact that duration of the event was three days and, therefore, control, if at all, would be for that period only."[89] The Supreme Court of India did not regard the taxpayer's presence as ephemeral or fleeting, or sporadic. "The fact that RPC-2011's tenure is of five years meant that there was a repetition," which makes it sufficient to constitute a fixed place PE.[90] This case shows important business activities carried on in source states for a limited period but which generate substantial revenue could lead to a fixed PE.

Moreover, there is no policy rationale to prescribe a fixed period for such activities if the state's tax base is indeed affected.[91] Thus, if Enterprise A's senior executive, who is a tennis fanatic and religiously travels to the United Kingdom for the Wimbledon Tennis Championships, works remotely from his London apartment for the duration of the tennis tournament, he may create a taxable presence for Enterprise A in the United Kingdom. This is because of recurring business activities (accounting services) conducted at the senior executive's apartment.

Secondly, "where the activities constituted a business carried on exclusively in that country; in this situation, the business may have a short duration because of its nature, but since it is wholly carried on in that country, its connection with that country is more substantial"[92] - considering a situation where a person who enjoys cooking authentic South African dishes with a healthy twist has learned that as part of the T20 Cricket World Cup hosted in the United Arab Emirates the organisers have decided to serve authentic dishes from the respective countries participating during the event. The person signs up as the caterer for the South African dishes during the two months of the World Cup event. The person did not pursue any other business activities before the enterprise was terminated after two months, and the enterprise business was

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[88] Ibid at 50.
[89] Ibid
[90] Ibid at 70.
[91] D.P. Sengupta, Chapter 7: *India: Formula One World Championship Case – Three Days May Be Sufficient to Constitute a Fixed Place PE* in Tax Treaty Case Law around the Globe 2018 (E.C.C.M. Kemmeren et al. eds., IBFD 2019), Books IBFD (accessed 2 Feb. 2022).
[92] Paragraph 30 of the OECD Commentary (2017) on Article 5(1).

carried on only at the stadium's kitchen. Accordingly, the time requirement for a PE could be considered to be satisfied.

3.2.1.3 At the disposal of or right of use

It is unclear as to what is meant by "at the disposal of" as neither the OECD Commentary (2017) nor the UN Commentary (2017) define the principle but notes that "it will depend on whether the enterprise has the effective power to use the premises".[93] It continues to explain the principle by examples:[94]

> *"Where an enterprise has an exclusive legal right to use a particular location which is used only for carrying on that enterprise's own business activities (e.g. where it has legal possession of that location), that location is clearly at the disposal of the enterprise. This will also be the case where an enterprise is allowed to use a specific location that belongs to another enterprise or that is used by a number of enterprises and performs its business activities at that location on a continuous basis during an extended period of time. This will not be the case, however, where the enterprise's presence at a location is so intermittent or incidental that the location cannot be considered a place of business of the enterprise (e.g. where employees of an enterprise have access to the premises of associated enterprises which they often visit but without working in these premises for an extended period of time). Where an enterprise does not have a right to be present at a location and, in fact, does not use that location itself, that location is clearly not at the disposal of the enterprise; thus, for instance, it cannot be considered that a plant that is owned and used exclusively by a supplier or contract-manufacturer is at the disposal of an enterprise that will receive the goods produced at that plant merely because all these goods will be used in the business of that enterprise."*

> *"A[n] … example is that of a painter who, for two years, spends three days a week in the large office building of its main client. In that case, the presence of*

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[93] Paragraph 12 of the OECD Commentary (2017) on Article 5(1).
[94] Ibid.

the painter in that office building where he is performing the most important functions of his business (i.e. painting) constitute a PE of that painter.”[95]

The OECD inserted these examples to clarify what is meant by the phrase “be at the disposal of an enterprise”. One of the leading cases on the matter is R v Dudney.[96] Taxpayer William Dudney was a resident of the United States and earned income by performing certain training services in Canada as an independent contractor. The taxpayer provided the services at a Canadian company’s premises for 340 days over two years. He had access to various rooms, small and large, and even the conference room. The use of the spaces was strictly limited to and only available to him for the training contract during office hours. The taxpayer could use the telephone in the offices but only for purposes of the contract. The Canadian Court of Appeal considered what the taxpayer used the premises for, “whether and by what legal right the person exercised or could exercise control over the premises, and the degree to which the premises were objectively identified with the person’s business.”[97] Based on those factors, the Court of Appeal concluded that although the taxpayer had access to the office and had the right to use it, it was not where the taxpayer carried on his business. He could only use the office during office hours and solely for performing his services under the contract.

In *Rolls-Royce plc v Director of Income Tax*[98], the taxpayer, a UK tax resident, supplied certain spare parts and equipment to Indian customers. Its subsidiary company, Rolls-Royce Indian Ltd (RRIL), has offices in India and rendered liaison services in India, for which it is remunerated by the taxpayer. The taxpayer’s employees visited India frequently, and the employees occupied the premises of RRIL during those visits. The court concluded that “RRIL creates a taxable presence (i.e. PE) for the taxpayer in India because the activity is a core activity of marketing, negotiating, selling of the product, which is a virtual extension of the taxpayer’s customer-facing business unit, which has the responsibility to sell the products belonging to the group. RRIL acts almost like a sales office of RR plc and its group companies. RRIL and its employees

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[95] Paragraph 17 of the OECD Commentary (2017) on Article 5(1).
[96] *R v Dudney* (2000) 2 ITLR 627.
[97] Ibid.
[98] *Rolls-Royce plc v Director of Income Tax (International Taxation)* and related appeals (2008) 14 ITLR 180.

work wholly and exclusively for Rolls-Royce plc and the Group. RRIL and its employees are soliciting and receiving orders wholly and exclusively on behalf of the Rolls-Royce Group. Employees of Rolls-Royce Group are also present in various locations in India, and they report to the director of RRIL in India. The personnel functioning from the premises of RRIL are, in fact, employees of Rolls-Royce plc".[99]

The courts have also considered the principle "at the disposal of" in the home office context. In *Universal Furniture Ind. AB v Government of Norway*,[100] a Norwegian salesman, worked four days a week soliciting new potential customers for a Sweden company that sold furniture designed and produced in the far East. On the last day of the salesman's workweek, he worked from home, planning the following week's sales work, writing reports, taking conference calls, and other related paperwork. For less than a year, the Taxpayer was compensated by the Sweden company for his telephone, fax, and general office equipment at home. The Norwegian tax authorities argued that the Sweden company had a PE in Norway in the salesman's home office. The Court accepted the Norwegian tax authorities' arguments that the Sweden company had a PE. Even though the agent spent one day per week at the premises, the work performed at home was regarded as the core activity of the Sweden company.

In a similar vein, in *Sunbeam Corp. v Minister of National Revenue*[101], the Canadian Court found that the sales representatives' home offices do not constitute the taxpayer's fixed place of business because the taxpayer did not pay rent or added compensation for the sales representatives operating from their home offices. Each sales representative provided their own office equipment, and the residences did not carry any business signs indicating that they were the taxpayer's representatives.

The *Knights of Columbus v R*[102] and *American Life Insurance Company v Canada*[103] both concerned whether an American insurance company had a PE in Canada through which it carried on business. The Canadian Tax Court concluded in both cases

[99] Ibid.
[100] *Universal Furniture Ind. AB v Government of Norway* (1999) 99-00421.
[101] *Sunbeam Corp. v Minister of National Revenue* 1962 CarswellNat 283, [1962] C.T.C. 657, [1963] S.C.R. 45, 36 D.L.R. (2d) 91, 62 D.T.C. 1390
[102] *Knights of Columbus* v R 2008 TCC 307 10 ITLR 827.
[103] *American Life Insurance Company v Canada* 2008 TCC 306 11 ITLR 52.

that the American insurance companies did not carry on business in Canada through a PE for the following reasons: (i) the American companies did not have any right of disposition over the home offices of their field agent representatives – they do not rent or own any of the home offices; (ii) the representatives have no signage on their property; (iii) they do not meet prospective clients at their home offices, (iv) no operational decisions are made at the representatives' offices; and (v) all risks connected with carrying on business at the home offices are borne by the representatives themselves.

In a recent tax ruling issued by the Spanish General Directorate of Taxes ("GDT")[104], an employee's home office situated in Spain was not at the disposal of his UK employer company for the following reasons: "(i) the business activity that the employee previously performed in the UK did not change as a result of his move to Spain; (ii) the UK employer company did not require the employee to move to Spain it was purely a personal decision; (iii) the UK employer company did not bear any costs related to the employee's stay in Spain; and (iv) the employee had an office available to him at the UK employer's offices in London throughout his employment."[105]

From the above analysis of case law, much depends on the nature of the business and the nature of the activities carried on at the fixed place of business. It appears that paying for the maintenance or operation of the home offices – paying rent and compensating for office equipment expenses – may be sufficient to comply with the "at the disposal of" principle.

The approach followed by the courts in these cases is in line with the OECD Commentary (2017), which notes that "[w]hilst no formal legal right to use a particular place is required for that place to constitute a PE, the mere presence of an enterprise at a particular location does not necessarily mean that that location is at the disposal of that enterprise. Whether a location may be considered to be at the disposal of an enterprise in such a way that it may constitute a place of business through which the business of [that] enterprise is wholly or partly carried on will depend on that enterprise

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[104] Saenz de Navarrette Crespo et.al. *Spain's Tax Authority issues ruling on remote workers and PEs during and after COVID-19 restrictions* at https://taxnews.ey.com/news/2022-0162-spains-tax-authority-issues-ruling-on-remote-workers-and-permanent-establishments-during-and-after-covid-19-restrictions?uAlertID=Sd%2FG8rua1oj6%2Fl58EZ2AiA%3D%3D (accessed on 11 February 2022).
[105] Ibid.

having the effective power to use that location as well as the extent of the presence of the enterprise at that location and the activities that it performs there."[106] (emphasis added)

From the above passage, it is clear that while factual use is sufficient to establish a PE, the right of use test is qualified by several conditions:

- Firstly, the enterprise should have "**effective power**" to use the place of business.
- Secondly, the enterprise's right of use depends on the **extent of the presence** of the enterprise and its business activities performed at the location.
- Thirdly, the OECD Commentary (2017) states that the "right of use" test is satisfied if the business activities are performed at the place of business on a "**continuous basis** during an extended period of time." The OECD Commentary (2017) further clarifies this condition stating that a PE will not exist "where the enterprise's presence at the location is so intermittent or incidental".[107] In Formula One, the Supreme Court of India did not consider the three-day event of the taxpayer intermittent given that the tenure was for five years.[108]
- Finally, the enterprise should perform its activities at the location. The likely interpretation is that the business connectivity test should also be complied with for purposes of the right of use test.[109]

3.2.1.4 Through which the business is carried on

Lastly, to meet the requirements of the general definition, the enterprise's business must be carried on wholly or partly through the place of business regularly.[110] The word "through" should not be interpreted in the narrow sense. Rather including "business activities occurring in, on, at, or through the fixed place of business.[111] It is important to analyse what business activities are performed and how. Further, one should examine whether the business activity conducted at the premises is a core

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[106] Paragraph 12 of the OECD Commentary (2017) to Article 5(1).
[107] Paragraph 12 of the OECD Commentary (2017) on Article 5(1).
[108] *Formula One*, *supra* n. 87 at pg. 32.
[109] Skaar, *supra* n. 31 at 11.4.4.
[110] B.R. Obuoforibo et al., *supra,* n. 85 at pg. 140.
[111] *Unisys Corporation v Federal Commissioner of Taxation* 5 ITLR 658 [2002] NSWSC 115.

activity to the business or merely a preparatory or auxiliary nature. For instance, Enterprise A, which produces authentic South African food products, sends an employee to State X to collect information about the culinary interests of the citizens of State X to assess whether State X is an appropriate state to export to. In such a case, the activities for the employee amount to preparatory and auxiliary nature and will not constitute a PE in terms of Article 5(4) of the OECD Model or UN Model. Importantly, for the place not to be treated as a PE it should "merely be preparatory or auxiliary".[112] The OECD recognises that it is difficult to distinguish between activities that are merely preparatory or auxiliary and those that have a preparatory or auxiliary character. In this regard, the OECD Commentary (2017) states that one should consider "whether or not the activity of the fixed place of business in itself forms an essential and significant part of the enterprise's activity as a whole".[113] In this regard, it could be arguable that a paralegal, who is conducting legal research services, services are merely auxiliary to the business activities of a law firm.

3.2.2 Services PE

Since its first publication in 1980, the UN Model (2021) included a deemed services PE provision with the aim that source states using a treaty based on the UN Model (2021) can confirm "the existence of a PE based on the provision of services without the need to argue the existence of a fixed place of business through which the business was being carried on".[114] Whether the enterprise is furnishing services[115] will turn on the nature of contractual arrangements.

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[112] Paragraph 58 of the OECD Commentary (2017) on Article 5.
[113] Paragraph 59 of the OECD Commentary (2017) on Article 5.
[114] A. Miller, *Taxing Cross-Border Services: Current Worldwide Practices and the Need for Change* at 8.1 (2015), Books IBFD.
[115] The term "services" is an undefined term within the respective model and will be determined "in accordance with the domestic law of the state applying the treaty rules unless the context of the treaty dictates otherwise" (see Article 3(2) of the respective Models). The author considers that the definition of services should not be interpreted as wide so to include charitable services. Instead, it should be interpreted as "the act of doing something useful for a person or company for a fee" (Black's Law Dictionary). Similarly, the definition is appropriate for purposes of enterprise that performs services under the alternative services PE of the OECD Model. Important to note that the research for this dissertation is limited to the services provided by enterprises and does not consider the services provided by persons (employees, directors or top-level managers) to enterprises.

The UN Model services PE provision[116] and OECD Model alternative services PE provision[117] reads as follows, respectively:

3. *"The term "PE" also encompasses:*
   (a) …
   (b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned."

"Notwithstanding the provisions of paragraphs 1, 2 and 3, where an enterprise of a Contracting State performs services in the other Contracting State"

(a) "through an individual who is present in that other State for a period or periods exceeding in the aggregate 183 days in any twelve month period, and more than 50 per cent of the gross revenues attributable to active business activities of the enterprise during this period or periods are derived from the services performed in that other State through that individual, or"

(b) "for a period or periods exceeding in the aggregate 183 days in any twelve month period, and these services are performed for the same project or for connected projects through one or more individuals who are present

[116] Article 5(3)(b) of the UN Model (2021). The ATAF Model (2019) contains an identical services PE provision, but do not prescribe a minimum time period to deem a service PE to exist. In contrast the UN Model (2021) and OECD Model (2017) stipulates a period of 183 days in any 12-month period.
[117] Paragraph 144 of the OECD Commentary (2017) on Article 5.

and performing such services in that other State"

"the activities carried on in that other State in performing these services shall be deemed to be carried on through a PE of the enterprise situated in that other State, unless these services are limited to those mentioned in paragraph 4 which, if performed through a fixed place of business (other than a fixed place of business to which paragraph 4.1 would apply), would not make this fixed place of business a PE under the provisions of that paragraph. For the purposes of this paragraph, services performed by an individual on behalf of one enterprise shall not be considered to be performed by another enterprise through that individual unless that other enterprise supervises, directs or controls the manner in which these services are performed by the individual."

A significant distinguishing factor between the UN Model services PE provision and the ATAF Model services PE provision and OECD Model alternative services PE provision is that the latter provisions are deeming provisions. Both services PE provisions stipulated that a PE is deemed to exist in the respective article.[118]

The opening phrase of Article 5(3) reads:

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[118] See Article 5(3)(b) of the ATAF Model (2017) and paragraph 144 of the OECD Commentary (2017) on Article 5. See also *CZ: Supreme Administrative Court*, 13 January 2011, 9 Afs 66/2010-189, Tax Treaty Case Law IBFD.

"[t]he term "PE" also encompasses …" (own emphasis)

The Cambridge English Dictionary online defines "encompasses" as "*to include different types of things*".[119] Although the UN Model Commentary (2021) indicates that the article is a deeming provision, it is open to interpretation whether the services PE provision of the UN Model is indeed a stand-alone provision.

Accordingly, depending on the interpretation by the courts of tax treaties following the UN Model the conditions of Article 5(1) of the UN Model (2021), the furnishing of services within the source state would merely be *prima facie* evidence that business activities are conducted and that the criteria of Article 5(1) of the UN Model (2021) must still be satisfied. And OECD Model (2017) does not have to be met in addition to the conditions of Article 5(3)(b) of the UN Model and OECD alternative services PE provision, respectively, for it to constitute a PE. However, in the absence of these PE provisions, a PE may only arise when conditions of a fixed place of business under Article 5(1) of the respective models are fulfilled.

The services PE has been considered numerous times by the Indian courts in secondment arrangements[120]. India's landmark Supreme Court ruling in this regard is *DIT (International Taxation) v Morgan Stanley & Co Inc*[121] , wherein the taxpayer, an American company, deputed employees to its Indian subsidiary to work under the control and supervision of the Indian subsidiary. Based on the facts of the case, the Supreme Court of India held that the taxpayer has a services PE in India because the secondees retain their *lien* on their employment with the taxpayer. The secondees lend their experience to the Indian subsidiary as the taxpayer's employee. The Court concluded that the services PE provision modelled to the UN Model services PE provision was a stand-alone provision. In *Centrica India Offshore Private Ltd v Commissioner of Income Tax and Others*[122], the high court followed the ruling of Morgan Stanley & Co Inc that if the seconded employees retain the legal employment

[119] https://dictionary.cambridge.org/dictionary/english/encompass
[120] A typical secondment arrangement is where an enterprise makes available its employee to work for an enterprise in the other state (host state).
[121] *DIT (International Taxation) v Morgan Stanley & Co Inc* (2007) 9 ITLR 1124.
[122] *Centrica India Offshore Private Ltd v Commissioner of Income Tax and Others* (2012) 16 ITLR 957.

with their home country employer, they may constitute a services PE for their home country employer in the foreign country.

Unlike the UN Model (2021) and ATAF Model (2019) services PE provisions, the OECD alternative services PE provision sets an additional threshold to the time threshold, being that "more than 50% of the gross revenues attributable to active business activities of the enterprise during this period or periods are derived from the services performed in that other State …".[123] In *Wolf v R*[124], the Canadian tax court raises the issues concerning the meaning of "enterprise", "business", and "gross revenues attributable to active business activities". The taxpayer, a resident of the United States of America, was an expert in designing aircraft fuel lines. He held a patent he licensed to an American company of which he was the shareholder and sublicensed the patent. During the 2012 tax year, the taxpayer received business income through his interest in the American company, income from the provision of services in Canada, and royalty income. Based on the facts of the case, the Canadian tax court held that the degree of interlacing and interdependence between the three income streams is such that both the Canadian and US commercial activities were part of the same enterprise. Accordingly, the Canadian tax court concluded that the income earned for services rendered in Canada amounted to 50% of the gross active business revenues of the taxpayer.

Another distinguishing factor between the UN and ATAF Model services PE provision and the OECD alternative services PE provision is that an enterprise performs services for the same project or connected projects. With the revision of the UN Model in 2017, the Committee considered the words "for the same or a connected project" undesired as it was easy to manipulate and created complex interpretive issues.[125] From a policy perspective, "if the non-resident provides services in a country for more than 183 days, the non-resident's involvement in the economic life of that country justifies the country taxing the income from those services, whether it is for one or multiple projects."[126]

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[123] Paragraph (a) of the alternative services PE provision of the OECD Model.
[124] *Wolf v R* 2018 TCC 84, 21 ITLR 506. The Canadian Tax Court decision was later confirmed by the Canadian Federal Court of Appeal 2019 FCA 283, 23 ITLR 1.
[125] Paragraph 12 of the UN Commentary (2017) on Article 5(3).
[126] Ibid.

The OECD Commentary (2017) indicates that in determining whether the services performed are for connected projects, one should consider all facts and circumstances. The relevant factors in this regard include:

- "whether the projects are covered by a single master contract;
- where the projects are covered by different contracts, whether these different contracts were concluded with the same person or with related persons and whether the conclusion of the additional contracts would reasonably have been expected when concluding the first contract;
- whether the nature of the work involved under the different projects is the same;
- whether the same individuals are performing the services under the different projects".[127]

The significance of the services PE provision is that one does not require a physical place of business if the enterprise has "employees or other personnel"[128] (or "an individual"[129]) in the source state.[130] The inclusion of "other personnel" embodies the scenario where an enterprise hires independent contractors to perform the services. Arnold correctly questions whether a subcontractor hired by a non-resident enterprise who is not working under the supervision or control of that enterprise or where the services provided by the subcontractor are ancillary to that of the enterprise should be considered a constituting a services PE.[131] Skaar argues that the non-resident enterprise should have a sort of "right of use" to the personnel, sort of control over the personnel because the person has to be "engaged" by the non-resident enterprise.[132] This aspect is clarified explicitly in the alternative service PE provision of the OECD Model. An independent contractor (or an individual) will only be considered as performing the services on behalf of the non-resident enterprise if the enterprise has control over, supervises, or directs how the independent contractor performs the services. [133]

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[127] Paragraph 162 of the OECD Commentary (2017) on the Alternative services PE provision of the OECD Model.
[128] Article 5(3)(b) of the UN Model.
[129] Alternative services PE provision of the OECD Model.
[130] Skaar, *supra* n. 31 at 10.7.1
[131] Arnold, *supra* n. 13 at 5.1.1.2.4.
[132] Skaar, *supra* n. 31 at 10.7.1.
[133] Alternative services PE provision of the OECD Model.

Another significant aspect is that the services PE provisions both are applicable based on where the services are furnished and not where the services are consumed or used. It does not matter whether the consumer is a resident of the source state.[134] However, an important policy issue in this regard is when can a foreign enterprise furnishing service in a state "be considered to be participating sufficiently in the commercial and economic life of another state to justify taxation of the enterprise by that other state."[135]

A minimum of 183 days of presence in a state is considered proper given that it is broadly consistent with the six-month minimum time required established in the Commentaries for a fixed place of business PE.[136] It is important to note that paragraph (a) of the OECD alternative services PE provision considers the days of *presence* whereas paragraph (b) of the OECD alternative services PE provision and UN Model services PE provision consider the days of *work*. The difference is that the one considers the days only on which the services are performed and the other not. The ATAF Model services provisions do not prescribe any minimum threshold number of days, which must be decided through negotiation between contracting parties.[137] On the other hand, is any number of days threshold appropriate? The respective models do not stipulate a threshold for the fixed place of business PE. The OECD Commentary merely suggests that six months may be appropriate. Formula One shows that essential business activities can be carried on in source states for a limited period but generate substantial revenue. Therefore, it may be appropriate to prescribe no fixed time for the services PE provision if the tax base of a source state is affected. When under Article 17 of the OECD Model (2017), sportspersons and entertainers are required to pay taxes in the source states even for short-term activities, the rationale for limiting the source state's taxing right becomes less compelling. Perhaps the OECD's threshold of "more than 50 percent of the gross revenues attributable to active business activities of the enterprise during this period or periods are derived from the services performed in that other State" could be an appropriate alternative?

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[134] Arnold, *supra* n. 13 at 5.1.1.2.4. Paragraph 152 of the OECD Commentary to Article 5.
[135] Paragraph 11 of the OECD Commentary (2017) on Article 7,
[136] B.J. Arnold, *The Taxation of Income from Services under Tax Treaties: Cleaning Up the Mess* – Expanded Version, 65 Bull. Intl. Taxn. 2 (2010), Journals IBFD
[137] See ATAF Commentary (2019) on Article 5(3)(b) of the ATAF Model.

As to the meaning of the terms “gross revenues” and “active business activities”, the OECD Commentary (2017) explain:

> *For the purposes of the second condition, according to which more than 50 per cent of the gross revenues attributable to active business activities of the enterprise during the relevant period or periods must be derived from the services performed in that State through that individual, the gross revenues attributable to active business activities of the enterprise would represent what the enterprise has charged or should charge for its active business activities, regardless of when the actual billing will occur or of domestic law rules concerning when such revenues should be taken into account for tax purposes. Such active business activities are not restricted to activities related to the provision of services. Gross revenues attributable to “active business activities” would clearly exclude income from passive investment activities, including, for example, receiving interest and dividends from investing surplus funds. States may, however, prefer to use a different test, such as “50 per cent of the business profits of the enterprise during this period or periods is derived from the services” or “the services represent the most important part of the business activities of the enterprise”, in order to identify an enterprise that derives most of its revenues from services performed by an individual on their territory.*

In *Wolf*,[138] the Canadian Tax Court – as confirmed by the Canadian Federal Court of Appeal – identified four conditions for measuring the gross revenues:

> *“In light of the words used in the Convention and the OECD commentaries, the Court notes four requirements relevant to measuring the gross active business revenues of Mr Wolf’s US enterprise. First, sources of revenue must be attributable to the US enterprise that provided the services. Second, the gross revenue amounts included in the calculation are amounts before tax. Third, passive investment revenues are excluded from the aggregation of revenue from different sources. And fourth, the relevant period during which gross active business revenues are measured is the same period during which the individual was in the contracting state.”*

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[138] Wolf *supra* n. 124 at 42.

While the above provides guidance, the source state is ultimately entitled and obliged to interpret the terms "gross revenue" and "active business activities" in its domestic law.[139]

3.2.3 Agency PE

If a non-resident enterprise does not have a fixed place of business in a source state within the meaning of the basic PE rule, a PE may still exist for the non-resident enterprise.[140] A source state may enforce its taxing rights on a non-resident corporate due to the presence of a dependent agent, a person who is acting on behalf of the non-resident corporate entity "*and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are*

a) in the name of the enterprise, or
b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or
c) *for the provision of services by that enterprise.*"[141]

The OECD Commentary distinguishes between three main conditions for the constitution of an agency PE:[142]

- "A person must act on behalf of a non-resident enterprise;
- The person habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts without material modification by the enterprise; and
- The contracts concluded are:
    - in the name of the enterprise; or
    - for the transfer for the ownership of, or for the granting of the right to use property owned by that enterprise, or that the enterprise has the right to use; or

[139] Article 3(2) of the OECD Model (2017).
[140] Olivier and Honiball, *supra* n. 16 at 3.5.3.
[141] Article 5(5) of the OECD Model Convention on Income and Capital (2017). The agency PE provision reads similarly in Article 5(5) of the UN Model and ATAF Model, respectively.
[142] Paragraph 84 of the OECD Commentary (2017) on Article 5(5).

- for the provision of services by that enterprise."

It is important to note that even if all these conditions are met, an agency PE will deem not to exist if the person, who performs the activities on behalf of the enterprise, is independent as contemplated in Article 5(6) of the OECD Model, UN Model or ATAF Model, as the case may be. Nor will an agency PE be deemed to exist if the activities performed by that person are those under the "negative list" in Article 5(4) of the OECD Model, UN Model, or ATAF Model, as the case may be.

3.2.3.1 Act on behalf of the enterprise

A person is considered acting on behalf of an enterprise when that person involves the enterprise to a particular extent in business activities in the other state.[143] According to the OECD Commentary (2017), this may be an agent acting on behalf of "a principal, a partner who acts for a partnership, a director acts for a company, or an employee act for an employer".

3.2.3.2 Concludes contracts or plays the principal role

The OECD Commentary (2017) states that the relevant law governing contracts should be considered to determine whether, where, and how a contract was concluded.[144] However, the domestic law of respective states is likely to differ.[145]

The inclusions of the words "plays the principal role leading to the conclusion of contracts" aim at a situation where the contract's conclusion results directly from the agent's actions.[146] The doubt arose as to the existence of an agency PE where an agent negotiates all the terms of the contract in one state, and the contract is later formally concluded by signature in another state.[147] According to the OECD Commentary (2017), the test considers whether the agent's activities resulted in the third party entering into a contract with the enterprise.[148]

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143 Paragraph 86 of the OECD Commentary (2017) on Article 5(5). Paragraph 23 of the UN Commentary (2017) on Article 5(5).
144 Paragraph 87 of the OECD Commentary (2017) on Article 5(5). Paragraph 23 of the UN Commentary (2017) on Article 5(5).
145 Arnold, *supra* n. 13 at 3.2.1.
146 B.R. Obuoforibo et al., *supra,* n. 85 at 11.1.1.4.
147 *Issues arising under Article 5 of the OECD Model* at R(19)-32.
148 Paragraph 88 of the OECD Commentary (2017) on Article 5(5).

In *Conversant International Ltd (previously Valueclick International Ltd)*[149], the French Supreme Administrative Court recently considered whether a French subsidiary in France carried on the work of the Irish company. The taxpayer was an Irish company that carried out digital marketing services in all markets other than North America. In France, the taxpayer operated through a French company to provide marketing services, including identifying potential clients, concluding contracts that the taxpayer routinely approved, and providing support services. The French Supreme Administrative Court concluded that the taxpayer had an agency PE in France because the French company habitually decided on transactions. The taxpayer did no more than approve in Ireland.

3.2.3.3 The relevant contracts

The qualifying contracts that could constitute a PE for an enterprise in the other state are:

- "those concluded 'in the name of' the enterprise, which application is not restricted to those contracts that are literally in the name of the enterprise;
- contracts concluded for the transfer for the ownership or, or for the granting of the right to use property owned by that enterprise, or that the enterprise has the right to use; or
- those concluded for the provision of services by the enterprise"[150].

The concept "in the name of" has been interpreted by several jurisdictions, and the difficulty interpreting the concept arose due to the common law and civil law approach to the law of agency. According to the civil law of agency, contracts concluded between the commissionnaire and their client are not binding on the foreign enterprise.[151] According to the common law of agency, the principal is legally bound by the agreements entered into by the agent, even if that the contracts have taken place only in the name of the commissionnaire.[152] Whether a commissionnaire gives rise to a PE

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[149] *Minister for Public Action and Accounts v Socie´ te´ Conversant International Ltd* N° 420174, 24 ITLR 232.

[150] Article 5(5) of the OECD Model (2017).

[151] S. Austry, Chapter 7: *Agent PE: The "in the name of" Concept in New Trends in the Definition of PE* (G. Maisto ed., IBFD 2019), Books IBFD (accessed 10 Feb. 2022).

[152] Ibid. See also *Dell Products (NUF) v Tax East* HR-2011-2245-A, 14 ITLR 371.

of its principal was addressed in *Société Zimmer Ltd*[153]. The taxpayer is a UK incorporated and tax resident company resident that sold orthopaedic products in France through Zimmer SAS. Zimmer SAS acted as commissionnaire for the taxpayer in France under a commission contract whereby it agreed to represent the taxpayer in France. Zimmer SAS then enters into contracts with customers in its name and agrees to provide the taxpayer's products to those customers. The Administrative Court of Appeal concluded that Zimmer SAS does not have authority to conclude contracts binding on the taxpayer and therefore cannot constitute a PE for the taxpayer in France. The Supreme Court of Norway applied the same interpretation in *Dell Products*[154], being that agreements concluded by the commissionnaire in its name are not binding on the principal.

3.2.3.4 Habitually

The inclusion of the term 'habitually' "reflects the underlying principle of Article 5, that an enterprise maintains a level of presence in the other state."[155] However, the OECD Commentary (2017) notes that the term "habitually" encompasses mere presence and the extent and frequency of the activity. The OECD Commentary (2017) recognises that it is not possible to provide a precise frequency and therefore provides the following factors appropriate for considering frequency:[156]

- Recurring nature of activities;
- The duration of an enterprise's presence in the other state; or
- Whether the activities were exclusively carried on in that country.

Consider a scenario where Enterprise A tendered to provide accounting and tax services to Enterprise B, a non-resident enterprise expanding its retail business to State R, where Enterprise A is a resident. The executive management team travels to various destinations for a team-building retreat annually. The executive management team realises that this year they will have a 4-hour layover in State S, where Enterprise B is incorporated and effectively managed, to conduct an in-person presentation of its

[153] *Société Zimmer Ltd v Ministre de l'Économie, des Finances et de l'Industrie* N° 304715,308525, 12 ITLR 739. See also *Boston Scientific v Italian Revenue Agency* Judgement No 3769 Reference 137, 14 ITLR 1060.
[154] *Dell Products*, *supra* n. 152 at pg. 48.
[155] Arnold, *supra* n. 13 at 3.2.4.
[156] Paragraphs 28 to 30 of the OECD Commentary (2017) on Article 5(1).

services on offer as a deal-sweetener. It is questionable whether the executive management teams' presence could amount to them habitually playing the principal role leading to the conclusion of the contract for the provision of services to Enterprise B in State S.

3.2.3.5 Independent agent

An important qualification to the agency PE is that the person is not independent of the Enterprise as contemplated in Article 5(6) of the OECD Model (or Article 5(7) of the UN Model). Suppose the person is acting in the ordinary course of their business and does not act exclusively or almost exclusively for the enterprise. In that case, they will not constitute an agency PE.

3.3 Application of traditional source rules to remote working

To understand the risks and issues in applying the traditional PE types as stated in the OECD Model (2017), UN Model (2021), and ATAF Model (2019), one needs to understand how remote working arrangements operate and business services are rendered.

In most cases, remote working arrangements and cross-border business services operate across two or more jurisdictions, as explained below.

3.3.1 Illustration 1:

Enterprise A is a company incorporated in and effectively managed from State R that provides online tutoring services and maintains a customer network in State C. Enterprise A employed a new talented international employee X who resides in State S as an online tutor. Employee X has an office at her home suitably equipped for her to render her employment services at her own cost. Employee X does not have an office at her disposal in Enterprise A's office in State R.

State C's customers schedule various tutoring slots with Employee X via Enterprise A's online scheduling system, and all tutoring are via video calling.

3.3.2 Illustration 2:

Employee Y, a manager at Enterprise B engaged in tax and accounting services, decides to fulfil his desire to travel the world with his wife while working remotely for Enterprise B. Both Employee Y and Enterprise B are residents in State R. Enterprise B's current client base is primarily situated in State R.

Employee Y agreed with Enterprise B that the remote working arrangement would only be for three years, and therefore his stays in each state will be for three to six months at a time. Given the nature of Employee Y's employment, he does not require a dedicated workspace or place; therefore, the hotel room, rented apartments, or cafés he intends to visit will suffice. To the extent required, he will rent a space at a shared co-working space (for a more formal setting).

Employee Y planned his trips to various States according to his work schedule. During the filing of tax returns season in State R, which is from June to December each calendar year, Employee Y will be residing in the European States, which allows him and his wife to travel via train to different towns and take day trips without having too much disruption to his work schedule.

3.3.3 Illustration 3:

A senior manager, Employee Z, is a Formula One race car fanatic and decides to follow the races worldwide for an entire season from March to November each calendar year. Employee Z works at a consulting firm, Enterprise C in State R, which agrees to the remote working arrangement. Employee Z enjoys the hospitality of the Hilton Hotel Group and therefore only stays at one of the Hilton hotels in each State.

As a senior manager, Employee Z's duties include overseeing junior consultants and performing a quality check on all their work before being dispatched to the customers.

3.4 Difficulties in application to the abovementioned illustrations

3.4.1 Physical PE

As discussed in section 3.2, the PE principle requires a fixed place of business through which the enterprise's business is carried on. From a principle point of view, any part

of a dwelling, hotel room, shared space, street corner, etc., may serve as a place where business activities are performed.[157]

In illustration 1, State R is Enterprise A's residence state because it is incorporated there and effectively managed from that state. While State R may tax Enterprise A on its worldwide income on the residence basis, State S will claim taxing rights in its jurisdiction. For State S to claim taxing rights Enterprise A must have a PE in State S, which requires a fixed place of business. At the outset, one may argue that the home office of Employee X constitutes the fixed place of business as it is fixed both in a geographical and permanent sense. Moreover, it is worth noting that the tutoring services conducted from the home office of Employee X are the core business activity of Enterprise A.[158]

However, as noted by case law, the principal question to be addressed is whether the use of the home office is "at the disposal of" Enterprise A. Enterprise A does not bear any costs in maintaining the home office of Employee X in line with the stated case law this would have been sufficient to comply with the "at the disposal of" principle.[159] In the recent Spanish Tax Ruling,[160] they also considered that the employee had an office available to him, and he moved to Spain for personal reasons, not because his employer required him to do so. Accordingly, this case is distinguishable from the Spain Tax Ruling. In this regard, the OECD Commentary (2017) states the following:

> *18. Even though part of the business of an enterprise may be carried on at a location such as an individual's home office, that should not lead to the automatic conclusion that that location is at the disposal of that enterprise simply because that location is used by an individual (e.g. an employee) who works for the enterprise. Whether or not a home office constitutes a location at the disposal of the enterprise will depend on the facts and circumstances of each case. In many cases, the carrying on of business activities at the home of an individual (e.g. an employee) will be so intermittent or incidental that the*

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[157] Skaar, *supra* n. 31 14.1.1.
[158] Skaar, *supra* n. 31 14.2.1.
[159] *Universal Furniture Ind. AB v Government of Norway* (1999) 99-00421. *Sunbeam Corp. v Minister of National Revenue* 1962 CarswellNat 283, [1962] C.T.C. 657, [1963] S.C.R. 45, 36 D.L.R. (2d) 91, 62 D.T.C. 1390. *Knights of Columbus v R* 2008 TCC 307 10 ITLR 827. *American Life Insurance Company v Canada* 2008 TCC 306 11 ITLR 52.
[160] Saenz de Navarrette Crespo et al. *supra* n. 104 at pg. 36.

> *home will not be considered to be a location at the disposal of the enterprise (see paragraph 12 above). Where, however, a home office is used on a continuous basis for carrying on business activities for an enterprise and it is clear from the facts and circumstances that the enterprise* ***has required the individual to use that location to carry on the enterprise's business*** *(e.g. by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office), the home office may be considered to be at the disposal of the enterprise.*
>
> *19. A clear example is that of a non-resident consultant who is present for an extended period in a given State where she carries on most of the business activities of her own consulting enterprise from an office set up in her home in that State; in that case, that home office constitutes a location at the disposal of the enterprise. Where, however, a cross-frontier worker performs most of his work from his home situated in one State rather than from the office made available to him in the other State, one should not consider that the home is at the disposal of the enterprise because the* ***enterprise*** *did* ***not require that the home be used for its business activities****. It should be noted, however, that since the vast majority of employees reside in a State where their employer has at its disposal one or more places of business to which these employees report, the question of whether or not a home office constitutes a location at the disposal of an enterprise will rarely be a practical issue. Also, the activities carried on at a home office will often be merely auxiliary and will therefore fall within the exception of paragraph 4.*

As Kostić points out, the OECD Commentary (2017) is based on the classical understanding of the employment relationship wherein it is taken for granted that the employer has to provide the premises on which the employment is to be performed. If the employer does not provide the tools of the trade, one presumes that the employee is working from home.[161] Skaar also questions the reasoning noted in the OECD Commentary (2017), as the question whether or not the employer has "effective power" over the living quarters of the employee (referring to the conditions discussed

[161] Kostić, *supra* n. 15, p. 3.

in section 3.2.1.3),[162] and draws a distinction between cases where the employee due to the nature of their work is spending all of the working hours in the home office and cases where the home has a less significant role in the employee's work. In the former case, the employer's influence over the employee's home is real since the instructions issued by the employer concerning the performance of the employee's work are to be carried out in the employee's home. Through the right to instruct the employee, the employer indirectly exercises influence over the use of the employee's home.[163]

Whether a place of business is "at the disposal" of Enterprise A depends on whether Enterprise A has – as stated above (see section 3.2.1.3) – "effective power" to use Employee X's home office. The courts have previously concluded that it depends on whether the employer rents the home office, there is any signage on the property identifying the employer's business, the decision made at the home offices, whose decision it was to work from home, and is there an office available at the employer's premises for the employee.[164]

From illustration 1, it is evident that the home office will constitute the place of business for Enterprise A. It is identifiable by a specific geographical location. Employee X always renders the tutoring services from her home office. There is no signage on the property of Employee X identifying her as a tutor of Enterprise A, nor does Enterprise A bear any cost to the home office. However, it is not a personal decision by Employee X to work from home. It is as a result of the business model of Enterprise A that all employees work from home and that they do not provide employees with an office space. Accordingly, Employee X's home office is a fixed place of business at the disposal of Enterprise A.

Geographical and commercial coherency will be questioned if Employee X decides to render the tutoring services from the public library or her favourite public park.

However, illustrations 2 and 3 are distinguishable from illustration 1. Both illustrations 2 and 3 lack the degree of permanence required to establish fixedness. In Formula One, the Court ruled that three days spent a year was sufficient to establish a degree

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[162] Skaar, *supra* n. 31 at 14.2.2
[163] Ibid.
[164] *Knights of Colombus*, *supra* n. 102, *American Life*, *supra* n. 103, Saenz de Navarrette Crespo et al. *supra* n. 104 at pg. 36

of permanence because the relevant contract was renewable for five years. In illustrations 2 and 3, Employee Y and Employee Z will not be returning to the same place each year. The places of business where Employee Y and Employee Z render business services are not at the disposal of Enterprise B and Enterprise C because neither company bears the costs for hotel rooms, flights, and cafes. The Enterprises did not require the Employees to work remotely. They have offices available to the Employees. The German Supreme Court also previously rejected that a hotel room could constitute a PE, stating that the agent's right to use the hotel room and related facilities was equal to the other guests. Therefore, the right of use condition could not be satisfied. Economically, Enterprise B has a business life in Europe because Enterprise B's sales increase during the annual tax filing season. Employee Y is the tax compliance manager attending to the majority of those filings for Enterprise B.

From the above analysis of these illustrations, the author notes that an employee decides to work remotely for the enterprise in most instances and not the enterprise decision. As a result of the constant increase in the mobility of people and improved technology, employees are more and more dependent on their laptops and mobile phones to conduct their business services that a fixed place of business is no longer required and hence the lack of a degree of permanence at a specific geographical location within the source states to establish a physical PE. Kostić argues that the laptop (or any other related equipment) owned by employees cannot be deemed the place of business of an enterprise.[165] Kostić, therefore, recognises that it is not the equipment that forms the link to the geographical point, and the author adds that this would be the case regardless of whether or not the enterprise supplied the employee with the tools of the trade. Remote working arrangements are distinguishable from physical PEs created by substantial equipment like vending machines, pipelines, and computer services that operate without human intervention.[166] Specific to remote working arrangements, presence in a source is created by employees and personnel,

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[165] Kostić , *supra* n. 15, p. 3.

[166] *DE: BFH, 30 Oct. 1996, II R 12/92*, Federal Gazette (BStBl) II 1997, Tax Treaty Case Law IBFD, in which the Bundesfinanzhof (German Federal Tax Court, BFH) held that an underground pipeline owned by a Dutch company and used to transport oil and gas in Germany was a PE. J. Sasseville & A.A. Skaar, General Report, in IFA Cahiers 2009, vol. 94A. Is there a PE? (IFA 2009), Online Books IBFD.

the workforce of an enterprise, and it is through those employees and personnel that business is conducted.

3.4.2 Services PE

Under Article 5(3)(b) of the ATAF Model and the alternative services PE of the OECD Model, an enterprise will be deemed to have a PE in the source state if it is furnishing services "*through employees or other personnel engaged by*" it (or an individual, in the case of the OECD Model alternative) continuously in that state.

Considering illustration 1, a services PE exists for Enterprise A in Article 5(3)(b) of the ATAF Model due to Employee X providing tutoring services that continue in State S for a period or periods aggregating more than 183 days in any 12-month period. Similarly, the alternative services PE of the OECD Model, particularly in paragraph (b) of that services PE provision, Employee X will constitute a services PE for Enterprise A.

The difficulties in applying these services PEs can further be illustrated by illustrations 2 and 3:

- The "duration" test: a services PE can be easily circumvented by limiting the number of days spent by an employee or other personnel or an individual engaged by a non-resident enterprise. In illustration 2, Enterprise B could set a condition to Employee Y's remote working arrangement by requiring Employee Y not to spend more than 183 days in any particular state that it travels to. In illustration 3, Employee Z will not be in those respective countries for more than 183 days because the Formula One events are three-day events. Distinguishable from the Formula One case is that the event would return to India for each year for five years, establishing continuity and the substantial revenue generated during the three-day event indeed affected the tax base of India.
- The "same project or connected projects": As stated in the UN Commentary (2017), the wording "same project or connected projects" can easily be manipulated and create complex interpretive issues and factual determinations

for tax authorities.[167] The author further agrees that "from a policy perspective, if a non-resident provides services in a state for more than 183 days, the non-resident's involvement in the commercial life of that state justifies the state taxing the income from those services whether the services are provided for one project or multiple projects. The degree of the non-resident's involvement in the source state's economy is the same, regardless of the number of projects involved."[168] Consider Employee X, in illustration 1, under her employment agreement with Enterprise A, she is required to render tutoring services to many customers. Because Enterprise A concludes a servicing agreement with each customer individually, the tutoring assignments of Employee X are not connected to the same project or connected project, but generates substantial revenues for Enterprise A. Similarly, consider illustration 2, during the busy tax filing season Employee Y decides to stay in France for three months until the bulk of the filing season is done. Employee Y still travels to various parts of France. He attends to various clients' tax compliance affairs and generates significant revenues for Enterprise B. The individual projects are not the same project or connected projects.

- The "dependence" test: While the ATAF Model counteracts the possibility of enterprises abusing the services PE provision by engaging with independent agents or contractors to perform services. The OECD Model requires an individual's work to be performed under the supervision, direction, or control of the non-resident enterprise, thereby excluding independent agents or contractors from the services PE provision. The OECD continues to recognise the rationale for the exception, as is the case with independent agents.[169]

The UN Model services provision will similarly apply to the illustrations, as is the case with the ATAF Model, with the exception to the potential restrictions of the criteria in Article 5(1) of the UN Model.

[167] Paragraph 31 of the UN Model Commentary (2021) to Article 5.
[168] Paragraph 31 of the UN Model Commentary (2021) to Article 5.
[169] See paragraph 83 of the OECD Model Commentary (2017) to Article 5.

From the above analysis of these illustrations, the deciding factor remains the presence created by employees and personnel and the nature of the business services and activities rendered through those who generate the revenue.

3.4.3 Agency PE

Despite the updates provided under the 2017 versions of the OECD Model and UN Model to counteract the abuses of the agency PE, it does not provide a suitable minimum for source-based taxation of a non-resident enterprise with a remote workforce.

As noted in the previous section 3.2, the Agency PE is based on the premise that the person acting on behalf of an enterprise is concluding contracts or plays the principal role leading to the conclusion of contracts. The agency PE's application is restricted to an enterprise's workforce engaging with clients to obtain business for the enterprise. Accordingly, all three illustrations could be precluded from the agency PE's application and would not constitute PEs for the respective enterprises in State S. Suppose Employee Z plays the principal role leading to the conclusion of contracts for Enterprise C. Whether Employee Z constitutes an agency PE for Enterprise C will depend on the frequency of that activity in the respective countries. Moreover, Article 5(6) of the OECD Model (or Article 5(7) of the UN Model) provides for an Agency PE exclusionary rule which leaves room for abuse. An enterprise could only engage the services of independent persons rather than employees. It is also arguable that the conclusion of a contract does not generally generate profits. However, the work that flows from the contract, i.e. rendering of the service for which it is concluded generates revenue for the service provider.

3.5 Conclusion

In this chapter, the author has established that the presence of a foreign enterprise's workforce in a state can create a taxable presence for the foreign enterprise under the current PE framework. However, this is not without limitations.

The physical PE is limited to scenarios where the enterprise has effective power over the place of business where the workforce conducts the business activities. Moreover, a remote working scenario does not necessitate a fixed place of business because

employees and personnel can successfully perform business activities with limited resources, i.e., laptops, cell phones or tablets, and working internet.

The services PE is limited to a specific timeframe having been met, despite the significant business activities performed by the foreign enterprise's workforce present within the state.

The agency PE is limited to agencies that involve the conclusion of contracts and occur regularly within a state.

CHAPTER 4: CONCLUSION

4.1 Concluding remarks

The COVID-19 pandemic has shed light on the changing working environment whereby employees are no longer confined to the employer's workplace. Employees, specifically within the professional services industry, serve clients remotely from one state while their clients and employers are in other countries.

The object of this study was to assess whether under the PE concept as provided for in the international conventions of the OECD, UN, and ATAF state that host the workforce of foreign enterprises can claim taxing rights over the foreign enterprises' profits. The study's preliminary findings indicated that it is justified for those host states to tax the foreign enterprises' profits. However, until the foreign enterprise has a PE in that host state, should the host state not have tax rights on the foreign enterprises' profits. Accordingly, through illustrations, it was considered within the current PE framework of the OECD Model, UN Model, and ATAF Model whether a PE is created by the remote workforce of a foreign enterprise in a state. The findings highlighted the shortcomings of the PE concept concerning remote working:

- The advancements in technology provide for increased and continuous mobility of the workforce. As a result, a physical PE is not created due to the lack of permanence and geographical and commercial coherency.
- The services PE condition that the services relate to the "same project or connected projects" creates complex interpretive issues for tax authorities.
- The "duration" test allows for the avoidance of a services PE: a foreign enterprise can generate substantial revenue due to the services rendered by an employee in another state within a week without creating a taxable presence.
- The agency PE's limited application to the conclusion of contracts neglects the fact that the source of the profits, the work which a foreign enterprise does to earn the income flowing from the conclusion of the contracts, is done by an employee who may not be present when the contract is concluded.

4.2 Recommendation

The PE concept should be revisited to address these shortcomings, and the ATAF Model services PE provision, serves as the readily available solution for the following reasons:

- The provision does not consider whether the services are rendered to a resident of the source state, but that the services are rendered in the source by an employee or other personnel present in that state.
- The provision coincides with what constitutes "source": "*... (the source of the income) is not the quarter whence they come, but the originating cause of their being received as income and that this originating cause is the work which the taxpayer does to earn them, the quid pro quo which he gives in return for which he receives them",*[170] and which source of income can be through the employment of capital or manual or intellectual labour. [171] Considering the services sector, it involves the latter, and therefore source is where that labour is exercised.
- It addresses both employees and dependent agents and is not limited to individuals under the enterprise's supervision, direction, or control.
- There are no restrictions imposed by the criteria required by Article 5(1) of the ATAF Model as a PE "is deemed to exist subject only to the length of stay of the individual for purposes of performing the services."[172]

However, ATAF Model services PE provision is not recommended without modifications:

- An anti-avoidance measure for the "duration" test: Despite the broad application of the services PE of the ATAF Model, the number of days within a twelve-month threshold can give rise to abuse, whereby enterprises only conclude employment contracts for a fixed period to avoid the "duration" test being met. It is recommended that an anti-abuse rule is added as a proviso to the services PE provision.

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[170] *CIR v Lever Bros* 1946 AD 441 at 450. Applied in *CIR v Epstein* [1954] 4 All SA 7 (A).
[171] *Rhodesia Metals Ltd. (In Liquidation) v CoT* 1938 AD 282 at 299.
[172] ATAF Commentary (2017) on Article 5(3)(b).

Notice should also be given to the potential adverse effects of including a days-threshold. If the furnishing of services gives rise to substantial revenues, it affects the source state's tax base. Recognition of taxable presence could be restricted if it is only furnished for a short period. Reference is made to the Formula One case in this regard.

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