The Interplay of Permanent Establishmentsand International Taxation: A Close Look from Tanzanian Perspectives and Treaty Models

Sayed Qudrat Hashimy* &Jackson Simango Magoge**

Prologue

The concept of Permanent Establishment (PE) is a pivotal aspect of international taxation that holds immense significance in the global arena of taxation and cross-border trade. In this article, we embark on a comprehensive analysis of the notion of Permanent Establishment, delving into its various facets and exploring its critical implications. Additionally, we aim to provide a detailed examination of the concept of source rules and Permanent Establishment within the specific context of Tanzania.Permanent Establishment is a concept that lies at the intersection of international tax law and international business activities. It plays a fundamental role in determining the taxing rights of countries when a foreign enterprise engages in economic activities within their borders. The characterization of a business presence as a Permanent Establishment has profound consequences for the allocation of taxing authority between countries, as well as for the tax liability of multinational enterprises.[1]

At its core, a Permanent Establishment signifies a fixed and enduring place of business through which an enterprise carries out its activities. It is a threshold that, once crossed, triggers the application of a country's domestic tax laws and tax treaties. Understanding the criteria that define a Permanent Establishment is essential for businesses operating internationally, as it determines their obligations to comply with tax regulations and pay taxes in a foreign jurisdiction. Furthermore, the concept of source rules will be closely examined in conjunction with Permanent Establishment. Source rules dictate how income derived from various activities is allocated between countries, and they often intersect with the determination of a Permanent Establishment. Understanding the interplay between source rules and Permanent Establishment is crucial for both tax authorities and businesses to ensure compliance with international tax norms. This analysis aims to enhance understanding of its importance in global taxation.

Brief Background of Permanent Establishment

The notion of P.E. is a prominent feature in the domestic legislation of many nations. Its crucial role in the realm of global taxation led to its development

*** Ph.D Scholar (Law), Department of Studies in Law, University of Mysore.**
**** Assistant Lecturer at the University of Iringa (UoI), Tanzania.**

[1]Ruud de Mooij, Thornton Matheson and Roberto Schatan, 'Chapter 10. International Corporate Tax Spillovers and Redistributive Policies in Developing Countries', Inequality and Fiscal Policy (International Monetary Fund) <https://www.elibrary.imf.org/display/book/9781513531625/ch010.xml> accessed 4 December 2023.

[2]'MDT_2017.Pdf' 143 <https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf> accessed 7 October 2023.

on an international scale.[2] This concept of PE serves to differentiate between a taxpayer's activities conducted in a foreign country and those carried out domestically. Its primary aim is to ensure that business operations are only subject to taxation by a State when substantial economic ties are established between the enterprise and that particular state. The term "Permanent Establishment" first emerged in the Prussian Trade Regulation Act of 1845, which served as the industrial code of Prussia and was a model for municipal regulations in eastern Prussia.[3] These regulations suggested that the concept of "StehendesGewerbe" (a trade with a fixed place of business) should be subject to taxation in the respective municipality, even if the owner resided in a different municipality.

The draft of the 1927 Bilateral Convention for the Prevention of Double Taxation provided a definition for PE.[4] The convention included a list of establishments that would be considered as permanent. The definition didn't hinge on whether the traders themselves, their partners, or their attorneys or representatives used these establishments. The convention outlined PE as a genuine center of management, affiliated companies, branches, factories, agencies, warehouses, offices, and depots. The notion that a business engages with a foreign country through a legitimate independent agent (such as a broker or commission agent) did not imply the existence of a PE in that country.[5]

The 1928 Draft of the Bilateral Convention for the Prevention of Double Taxation revised the definition of PE.[6] It excluded affiliated companies but incorporated mining, oilfields, and workshops.[7] The 1933 Specific Convention on Profit Allocation expanded the scope of PE to encompass "real centers of management, branches, mines, oil wells, plantations, factories, workshops, warehouses, offices, agencies, installations, and other fixed places of business," while excluding subsidiary companies.[8] In 1958, the Organization for European Economic Cooperation, in its report, defined Permanent Establishment as a fixed place of business where the enterprise's activities are either wholly or partially conducted.[9] The OECD Model Tax Convention incorporated this definition under Article 5(1) in 1963 to provide a clear understanding of the concept of a P.E.[10]

The Permanent Establishment definition was amended to refer to a stationary business location where the enterprise conducts all or part of its operations.[11]From the

[3]Ruth Mason, 'The Transformation of International Tax' (2020) 114 American Journal of International Law 353.
[4]'MDT_2017.Pdf' (n 4).
[5] Article 5, League of Nations: Committee of Technicla Experts on Double Taxation and Tax Evasion Double Taxation and Tax Evasion: Report Document C.216.M.85.1927.II.
[6]<https://www.oecd-ilibrary.org/docserver/9789264218789-5-en.pdf?expires=1696699018&id=id&accname=guest&checksum=23CD727 BA10AEE8F22B87419503155A3> accessed 7 October 2023.
[7]Sebastien Leduc and Geerten Michielse, 'Chapter 8 Are Tax Treaties Worth It for Developing Economies?', Corporate Income Taxes under Pressure (International Monetary Fund) <https://www.elibrary.imf.org/display/book/9781513511771/ch008.xml> accessed 7 October 2023.
[8]Sharmendra Chaudhry, 'Double Taxation Avoidance Agreements' (8 April 2012) <https://papers.ssrn.com/abstract=2036494> accessed 7 October 2023.
[9] Organization for European Economic Cooperation: The Elimination of Double Taxation: 1st Report of the Fiscal Committee, 1958
[10] Article 5(1) of the OECD Model Tax Convention
[11] OECD MTC (1977)

definition, Under Article 5[12]entails two essential criteria. *Firstly,* there must be a "Place of business," which can be a physical location like premises or, in specific cases, machinery or equipment. *Secondly,* this place of business must be "fixed," indicating it should be established at a specific location with a certain level of permanence. Therefore, there needs to be a connection between the place of business and a particular geographical point to classify it as "fixed."

Nature of PE

In the case of *Irish Bank Resolution Corporation Limited and Irish Nationwide Building Society v The Commissioners for Her Majesty's Revenue and Customs*,[13] the UK Upper Tribunal examined the deductibility of national interest paid by two permanent establishments in the United Kingdom to their Irish headquarters during the period of 2003-2007. The dispute centered around the allocation of loans and interest charges to the Permanent Establishments as distinct entities. It was noted that:" The challenge in attributing revenues to a Permanent Establishment arises from its inherent nature. A Permanent Establishment is not a distinct legal entity; it is an integral part of the corporation it belongs to. Consequently, there is a linguistic difficulty in characterizing interactions between a company and its permanent establishments. Due to the impossibility of a person, in the same capacity, transacting with themselves, it is legally inconsequential to assert that a permanent establishment 'pays' interest to the company or that the company 'transfers' an asset to the permanent establishment. Such transactions, from a legal standpoint, cannot occur and essentially amount to internal accounting procedures within the company."

Conditions to Constitute PE

In the *Formula OneWorld Championship Ltd. v. CIT*,[14] India's Supreme Court outlined key conditions for a Permanent Establishment (PE). Firstly, it requires a fixed place of business, like an office or facility. This serves as the hub for the enterprise's operations. Secondly, substantial activities of the enterprise must occur at this location, from management to core operations. This landmark ruling sets a precedent for clear and consistent application of international tax principles within India's legal framework.

Test to Determine the Existence of PE

In his article, Aage Skaar has examined a significant Norwegian case widely recognized as the Pegrum case.[15] In this instance, the British technician was relocating his work location from one area to another. The highest court cited the OECD

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[12] Note 2, Article 5, OECD Commentary (1977)

[13] [2019] UKUT 0277 (TCC)

[14]*Formula One World Championship Ltd. v CIT* (International Taxation) [2017] 394 ITR 80/248 Taxman 192/80 taxmann.com 347 (SC)

[15] (1997) BRT 494

Model, which, in turn, outlines certain criteria to ascertain the presence of a Permanent Establishment, as outlined below.[16]

a) Objective Test: This test establishes the presence of a Permanent Establishment based on two criteria: firstly, the presence of a physical business location, and secondly, that location must be situated in one specific place or within a limited area.

b) Subjective Test: This test determines the existence of a Permanent Establishment based on two conditions: firstly, there must be a legal right to use the business location, and secondly, this right may be either for a defined period or without a set duration.

c) Functional Test: This test proposes that in order to determine if an enterprise possesses a Permanent Establishment, its primary business operations must be conducted from a fixed location. As a result, the court applied the first and second tests and concluded that it was sufficient to establish that the technician had neither a permanent business location nor any legal right to use the premises.

The Income Tax Act in Tanzania: Source Rule and PE Concept

In 2004, Tanzania introduced its present income tax legislation, repealing the prior Income Tax Act.[17] The primary objective behind this re-enactment of the Income Tax Act was to align it with the evolving demands of contemporary tax regulations,[18] in contrast to trends seen in other jurisdictions.[19] These changes have both direct and indirect implications for domestic taxation and the nation's economy. The Act sets forth guidelines for distinguishing between income derived domestically and from foreign sources, as well as outlining regulations related to payments and expenses. It also provides clarity on the concept of residency for individuals and companies, and defines the scope of Tanzania's income tax liability.[20]

Source Rule in Tanzania

As with any nation, Tanzania follows its own set of domestic principles (fundamental source rules) to ascertain the origin of income for taxation purposes. Typically, this is established by the location of the economic activity generating the income, where profits are earned. Often, the determination of source is based on established tax practices rather than specific statutory criteria. In general, income derived from activities within a country is considered sourced there.

[16] S. Rajaratnam and B.V. Venkataramaiah, *Commentary on Double Taxation Avoidance Agreements*, 4th ed. 2008 Part I, p.1.200; 'Snow White Treatise on Double Taxation Avoidance Agreements By S. Rajaratnam & B.V. Venkataramaiah Edition August 2020' (MakeMyDelivery) <https://www.makemydelivery.com/product/snow-white-treatise-on-double-taxation-avoidance-agreements-by-s-rajaratnam-b-v-venkataramaiah-edition-august-2020/> accessed 7 October 2023.

[17] The Income Tax Act, CAP 332

[18] Act no. 33 of1973

[19] Odd-Helge Fjeldstad and Mick Moore, 'Revenue Authorities and Public Authority in Sub-Saharan Africa' (2009) 47 The Journal of Modern African Studies 1.

[20] See The Tanzania Revenue Authority Hand Book on the Application of the Income Tax Act, 2004,1st ed 2009

Thus, the source rules establish where the income is generated and which jurisdiction holds the taxation authority over it.[21] In Tanzania, the income tax system applies the source rule to non-resident individuals, meaning that income is only taxed if it originates within the United Republic of Tanzania. This principle is outlined in the Income Tax Act.[22]

Section 67 stipulates that the assessment of a person's income or loss from employment, business, or investment is conducted separately for income originating in the United Republic of Tanzania and any income with a foreign source. Therefore, a non-resident is taxed solely on income derived within the United Republic of Tanzania. This principle was underscored in the Court of Appeal of Tanzania in the case of Commissioner-General (TRA) v. Aggreko International Project Ltd.[23]Income is deemed to originate in the United Republic of Tanzania if it aligns with the criteria outlined in section 68, in conjunction with section 69 which enumerates payments with a Tanzanian source. Furthermore, a non-resident individual is subject to taxation based on a nexus established by the presence of a Permanent Establishment, as defined in Section 3 of the Income Tax Act.

Permanent Establishment

According to Section 3 of the Income Tax Act, a "Permanent Establishment" is defined as a location where a person conducts business. This encompasses situations where a person operates a business through an agent, excluding a general agent with independent status acting in their usual course of business. It also includes a location where substantial equipment or machinery has been or is being used or installed, as well as a place where a person is involved in a construction, assembly, or installation project lasting six months or longer. This definition extends to locations where supervisory activities related to such projects are carried out.[24]

Types of Permanent Establishment

The Income Tax Act outlines two categories of Permanent Establishments in Tanzania: Domestic Permanent Establishment and Foreign Permanent Establishment.

(i) Domestic Permanent Establishment, as defined in Section 3 of the Income Tax Act, encompasses all permanent establishments of a non-resident individual, partnership, trust, or corporation located within the United Republic.

(ii) Foreign Permanent Establishment, also defined in Section 3 of the Income Tax Act, encompasses all permanent establishments of an individual, partnership, trust, or corporation situated in a country other than the one where the individual, partnership, trust, or corporation is a resident. However, this definition excludes any permanent establishment within the individual, partnership, trust, or corporation's own country of residence.

[21] See*Nathan v Federal Commissioner of Taxation* (1918) 25 CLR 183;24 ALR 286 (Australia)

[22] Cap. 332 [R.E. 2019]

[23]*Commissioner General (TRA) v Aggreko International Project Ltd* Civil Appeal No. 148 of 2018 (Unreported) P.21-22

[24] Cap. 332 [R.E. 2019]

Taxation of Permanent Establishments

Non-resident entities that possess permanent establishments in Tanzania are subject to a 30% corporate tax on income generated within the United Republic of Tanzania.[25] Additionally, there is an additional 10% tax on the actual or deemed repatriated income of the permanent establishment in Tanzania. This 10% tax is applicable regardless of whether the income has been remitted or not. According to the Income Tax Act, a permanent establishment and its owner are considered distinct entities for tax purposes.[26]

Principles of Taxation of Permanent Establishment

The Income Tax Act, under Section 70, lays out the taxation principles for Permanent Establishments. In cases where an individual or a company with a domestic or foreign permanent establishment falls under section 4(1)(a) (meaning they have the entire income for the year or are a company with continuous unrelieved loss for the year of income and the preceding two years, as calculated under section 19 of the Income Tax Act), their income tax liability is computed as if the individual/company and the permanent establishment were separate but related entities, and the permanent establishment was a resident of the country where it is located. Additionally, an individual with a domestic permanent establishment is taxed on the repatriated income of that establishment, in accordance with Sections 4(1)(b) (applying to individuals with a domestic permanent establishment with repatriated income for the year) and 74 (pertaining to unallocated income of controlled foreign trusts and corporations).[27]

Permanent Establishment of International Taxation

International taxation is a complex and multifaceted area of tax law that regulates how different countries tax income and transactions involving cross-border elements in the globalized world of commerce. It encompasses a comprehensive set of rules and principles.[28] This article delves deeply into the concept of Permanent Establishment as defined in international tax frameworks like the OECD Model, UN Model, and bilateral treaties established by Tanzania. Before delving into the details of Profit Entitlement (PE) and how it is understood within these frameworks, it is essential to establish a fundamental grasp of the overarching concept of international taxation. Essentially, international taxation encompasses the intricate system of tax principles and laws that become relevant when economic transactions and ventures extend beyond the boundaries of a single country.

It is the discipline that governs how countries exercise their taxing authority over income, profits, and transactions involving foreign entities or individuals.

[25]'Tanzania - Corporate - Taxes on Corporate Income' <https://taxsummaries.pwc.com/tanzania/corporate/taxes-on-corporate-income> accessed 7 October 2023.

[26] See Section 70 of the Income Tax Act

[27] According to section 3 of the Income Tax Act 'repatriated income' has the meaning ascribed to it under section 72 of the Act

[28]Mosquera Valderrama and Irma Johanna, 'The Interaction of Tax Systems and Tax Cultures in an International Legal Order for Taxation' (1 September 2008) <https://papers.ssrn.com/abstract=1550815> accessed 7 October 2023.

Essentially, international taxation provides the legal framework that outlines the tax responsibilities and rights of various stakeholders in the global economy. The significance of international taxation cannot be overstated. In a time of globalization, where businesses seamlessly operate across borders and individuals engage in transnational financial activities, the rules governing the taxation of cross-border income and transactions profoundly impact national revenues, economic growth, and international trade practices. These rules reflect the intricate interplay between national sovereignty and global economic integration. One of the fundamental concepts in international taxation is Permanent Establishment. Understanding the subtleties of Permanent Establishment is crucial for governments, multinational corporations, and tax professionals alike, as it affects how taxing rights are allocated and how double taxation is avoided.

International Taxation

International taxation involves taxing transactions that cross national borders.[29] It encompasses resident taxation (taxing residents on global income) and source taxation (taxing non-residents on income tied to the country). Despite the impact of globalization, the current international tax treaty system still mirrors the principles and structures established by the League of Nations in the 1920s. These principles were formulated in an era when international trade primarily involved tangible goods, and communication across borders was sluggish. During the inter-war period, the issue of double taxation emerged due to the overlapping claims of source and residence jurisdictions over cross-border income. The International Chamber of Commerce (ICC), advocating for businesses, emphasized the urgency of measures to prevent double taxation.[30] In 1928, the League of Nations introduced its initial model tax treaty to address this issue, laying the groundwork for the OECD Model, the UN Model, and modern tax treaties.[31]

International Tax Treaty Models

The UN Model and OECD Model are fundamental frameworks for international tax treaties. They provide guidelines for countries in negotiating bilateral tax agreements. [32]The UN Model focuses on addressing tax considerations between developed and developing countries, considering factors like economic disparities. The OECD Model offers comprehensive guidelines for allocating taxing rights in cross-border transactions, aiming for consistency and standardization. These models

[29]'Cross-Border Taxation' (The Tax Adviser, 1 March 2013) <https://www.thetaxadviser.com/issues/2013/mar/leibowicz-mar2013.html> accessed 7 October 2023.

[30]Sara L McGaughey and Pascalis Raimondos, 'Shifting MNE Taxation from National to Global Profits: A Radical Reform Long Overdue' (2019) 50 Journal of International Business Studies 1668.

[31] Michael Kobetsky, *International Taxation of Permanent Establishments: Principles and Policy* (Cambridge Tax Law Series 2011) pp.106- 151

[32]'Financing for Sustainable Development' <https://www.un.org/esa/ffd/publications/manual-bilateral-tax-treaties-update-2019.html> accessed 7 October 2023.

streamline international taxation, reducing complexities and uncertainties and promoting a conducive environment for global trade and investment.[33]These models serve as templates for countries when negotiating tax treaties, contributing to the standardization of tax treaties by incorporating common provisions.[34]In both models, profit allocation within an international enterprise is guided by the arm's length principle, also known as separate accounting. This principle aims to offer a fair approach to assigning profits to the permanent establishments of an international enterprise. According to this principle, the head office and permanent establishment of an international enterprise are treated as distinct entities for the purpose of attributing profits to the permanent establishments.

OECD Model Convention (OECD MC)

The OECD Model Tax Convention, rooted in the League of Nations' efforts in the 1920s-1930s, represents a significant milestone in global tax principles.[35] The League recognized the importance of international tax cooperation and laid the foundation for many principles now in the OECD Model. These early developments greatly influenced today's global tax treaties, leading to the establishment of the OECD and the formulation of the OECD Model, a key framework in current international tax agreements.[36] The primary objective of the OECD Model is to offer both OECD and non-OECD nations a standardized framework for determining how taxing rights are allocated among different jurisdictions and to deter tax avoidance. This Model places a strong emphasis on residence jurisdiction, given that OECD countries, being developed, tend to be net exporters of capital.[37] According to Article 7 of the Model Treaty, income from business activities can only be taxed in the source state if the enterprise maintains a permanent establishment as defined in Article 5 of the Model Treaty. The Article provides distinct definitions[38] of PE as follows;

Basic PE (Article 5(1) and 5 (2)) (Basic Rule of PE)

A Permanent Establishment, as defined in tax law, refers to a "fixed place of business through which the business of an enterprise is wholly or partly carried on." This establishment must fulfill specific criteria to be recognized as the foreign enterprise's operational base. In the context of Consolidated Premium Iron Ores Ltd., it signifies a physical location where the company conducts its operations, whether entirely or partially. This can include various forms such as offices, factories, warehouses, or any other facility where significant business activities take place.

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[33]'OECD' <https://www.oecd.org/ctp/treaties/model-tax-convention-on-income-and-on-capital-condensed-version-20745419.htm> accessed 7 October 2023.

[34] See Ross, International Tax Law: The Need for Constructive Change' in Stein (ed) *Tax Policy in the Twenty-First Century* (1998) 87-100, p.92

[35]Thomas Rixen, 'From Double Tax Avoidance to Tax Competition: Explaining the Institutional Trajectory of International Tax Governance' (2011) 18 Review of International Political Economy 197.

[36] Vogel, *Double Tax Treaties and their Interpretation* (University of California, 1986), p.11

[37]Ruth Mason, 'The Transformation of International Tax' (2020) 114 American Journal of International Law 353.

[38] There are just two types of PE in strict terms: basic PE and agency PE. Construction PE, as defined in paragraphs 5(3), is a subset of basic PE, as defined in paragraph 5. (1). There is no separate PE definition for the subsidiary PE.

It's crucial for this place of business to align with the operational needs and activities of the foreign enterprise. For Consolidated Premium Iron Ores Ltd., establishing a Permanent Establishment would imply having a physical presence in a particular jurisdiction that serves as a hub for conducting its business operations. This could involve activities like production, management, or administrative functions carried out within that specific location, creating a tangible nexus between the enterprise and the jurisdiction in question.[39]

A Canadian corporation that only had a mailing address in the US, without an office, phone number, employees, or any financial records or accounts, was not considered to have a Permanent Establishment (PE). The court ruled that a PE implies the presence of a functional office with staff capable of conducting day-to-day business operations, or a facility equipped for such purposes. Therefore, the fundamental criteria encompass the following:

a) The existence of a *"place of business,"* which could entail physical premises or in some cases, machinery or equipment.

b) This place of business must be *"fixed,"* meaning it must be established at a specific location with a certain level of permanence.

c) The enterprise's business activities must be conducted through this place of business by its own personnel.[40]

i)Place of Business

The term 'place of business' encompasses any physical location, facilities, or installations, regardless of whether they are solely dedicated to business activities. According to Vogel, it refers to "all the tangible assets that the company uses for carrying on the business."[41] Therefore, the only prerequisite is that the company has a specific amount of space available in the other state that it can utilize. This space need not be owned or leased by the enterprise and it doesn't have to be exclusively utilized by the enterprise. It may even be situated within the business premises of another company. Additionally, it can exist even if there's no immediate need for physical space for commercial operations, as long as a certain amount of space is designated. This space could be lawfully or unlawfully occupied. However, it's important to note that merely having a presence at a particular place does not automatically imply that it is at the enterprise's disposal.[42].

ii) **Fixed Place of Business**

The place of business must exhibit both temporal and spatial fixity, implying that there must be a distinct site (referred to as the "location test") where business operations are conducted, coupled with a certain level of enduring presence (permanence test). Additionally, there should be a tangible or geographical tie to

[39]*Consolidated Premium Iron Ores Ltd* (1959) 265F 2d. 320 (US).
[40] Article 5, para 2 of the OECD Commentary
[41]Charles Goldfinger, 'Intangible Economy and Its Implications for Statistics and Statisticians' (1997) 65 International Statistical Review / Revue Internationale de Statistique 191.
[42]Article 5 para 4-4.6. of the OECD Commentary

the business site. In cases where operations occur at multiple specific locations, these may be considered a singular 'place of business' if they collectively form a commercially and geographically cohesive entity.[43] This encompasses activities that are confined to a particular location, even if they have the potential to be relocated. For example, this includes activities like construction work, offshore oil drilling rigs, or regularly used locations such as pedestrian streets, outdoor markets, or temporary events like fairs.[44]

The permanence test denotes a level of durability, though not necessarily indefinite. The activities in question must occur with regularity, not as one-time or infrequent occurrences, and they must be conducted over a reasonable duration by the foreign enterprise. Temporary interruptions are not taken into consideration. If a business endures for a specific period, it may meet the criteria for a permanent establishment. In some cases, a very brief duration might suffice, depending on the nature of the business. Moreover, if the brevity of the period was due to extraordinary circumstances, it could still qualify as a place of business. Such circumstances could include the demise of a taxpayer, investment failure, or regular but short-term use.[45]

Additionally, the OECD Model Convention provides a non-exhaustive ("positive") roster of what constitutes a fixed place of business. This list encompasses entities such as a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry, or any location involved in the extraction of natural resources. Typically, for a management or branch to qualify as a permanent establishment, there would be a need for an office or comparable facilities. An office, in this context, serves as a fixed space for managing the administrative aspects of the business. While these are prima facie examples of potential permanent establishments, being on the list doesn't automatically confer permanent establishment status. They must still fulfill the criteria outlined in Article 5(1) to be officially recognized as a permanent establishment.[46]

When an enterprise initiates the necessary steps to conduct its operations from a fixed location, it establishes a permanent establishment. This classification excludes time spent on the establishment or setup of the business if these tasks are substantially separate from the core activities of the business. Similarly, when all activities associated with its primary function or the authorization to use for business purposes come to a halt, the existence of the permanent establishment also ceases.[47] It is important to highlight that a temporary pause in activities does not qualify as a closure

Moreover, as outlined in the commentary, operating the enterprise from a fixed location typically implies that individuals affiliated with the company (referred

[43]Francesco Capogrossi and others, 'Impact of the Digital Economy on Taxation' (2015) 1 EucotaxWintercourse.
[44] OECD Commentary: Article 5 para 5-5.4
[45] OECD Commentary: Article 5 para 6-6.3
[46]'Article 5 Permanent Establishment | READ Online' (oecd-ilibrary.org) <https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2014-full-version/article-5-permanent-establishment_9789264239081-8-en> accessed 7 October 2023.
[47] OECD Commentary: Article 5 para 11.

to as personnel) are responsible for conducting the company's affairs in the jurisdiction where the fixed place is situated. The category of personnel encompasses both formal employees and other individuals, such as dependent agents, who receive directives from the enterprise.[48]Therefore, a linkage between the business activities of the enterprise and its physical location must exist.

Construction Permanent Establishment (Article 5(3))

Construction PE, a subset of basic PE, encompasses any business activities related to construction or installation projects on a designated site. It must adhere to the core PE criteria, but notably, the "permanence test" is replaced with a "duration test" due to the inherently temporary and dynamic nature of construction or installation projects in terms of time and location.The term "building site" or "construction project" encompasses a wide range of activities, including the construction of buildings, roads, bridges, and canals, as well as tasks like renovations, pipeline installation, and excavation and dredging. This also encompasses all activities needed to complete the project, such as installation, demolition, and clearance. Maintenance and repair work are considered, but the transportation of materials to the site falls outside this definition.

Furthermore, an "installation project" refers to the assembly or arrangement of prefabricated elements or parts of movable objects. Both installations on construction projects and the introduction of new equipment are covered in the Commentary. On-site planning and supervision are also included in this definition.A construction or installation project is classified as a permanent establishment only if it extends beyond 12 months and meets the other prerequisites of basic PE. Importantly, a permanent establishment is deemed to exist right from the initiation of the project if the 12-month threshold is surpassed for any reason. The period commences with the preparatory work in the source jurisdiction and concludes when the installation is tested, formally handed over, or permanently abandoned. This also encompasses planned seasonal interruptions or other temporary breaks in the project's progress.

a) Agency Permanent Establishment (Article 5(5)

The necessity of a physical location for an agent, as stipulated in the primary provision for an agent (Article 5(1)), is supplanted by the agency provision (Article 5(5)). Even if an entity does not fulfill the conditions of the basic rule, it may still be regarded as having a presumed permanent establishment if it conducts business through a non-independent agent, as defined in Article 5(6). As a result, if a foreign company 'utilizes' an agent, it is not obligatory for it to possess a fixed place of business or the entitlement to use one. Consequently, the agency clause does not demand any particular business undertaking. It encompasses any activity that holds both fundamental and substantial importance to the principal's business.[49]

To be considered an agency permanent establishment, a "dependent agent" or, in the case of an "independent agent," one not conducting business in their own regular course, must satisfy specific criteria.[50] Firstly, they must act on behalf of

[48] OECD Commentary: Article 5 para 2.

[49] Arvid Skaar, *Permanent Establishment*, (Kluwer Law International, 1992) 464

[50] See Article 5(6)

the enterprise, serving as the principal representative. Secondly, they must possess the authority to negotiate and finalize contracts on behalf of the enterprise. Thirdly, this authority must be consistently and regularly exercised. Additionally, any contract entered into should pertain to the central operations or the most crucial and substantial business activity of the company.[51]

Hence, when these stipulated conditions are met, the concept of Permanent Establishment (PE) comes into effect, contingent upon the extent to which the individual or agent acts on behalf of the principal entity. In other words, the establishment of a PE is established to the degree that the individual carries out activities in representation of the principal entity. This implies that the degree of involvement and authority exercised by the person acting on behalf of the principal directly correlates with the presence and scope of the PE.[52]

Furthermore, it is imperative that the agent consistently exercises their authority to engage in transactions that directly pertain to the principal's central business operations. The regularity and frequency with which such transactions occur are contingent upon the nature of the contracts involved and the specific nature of the principal's business activities. This means that what constitutes a habitual exercise of authority may vary depending on the specific industry and the types of contracts involved. It is a nuanced assessment that takes into account the unique characteristics of the principal's business and the agent's role in facilitating transactions.[53].

The occasional exercise of authority does not constitute the establishment of a permanent agency. It is imperative that the authority is consistently and repeatedly applied, not just sporadically. The ongoing activity need not be performed by the same individual, as long as the agent's role endures over a specific period.As such, this section offers an alternative criterion for determining a permanent establishment, providing an exemption to the primary provision outlined in paragraph 5(1). If an agent, in a reliant capacity, possesses the authority to finalize contracts on a regular basis, they are classified as a permanent establishment. The agent need not have a designated place at their disposal to conduct the principal's business. Meeting the requirement detailed in Article 5(5) is not obligatory if the enterprise adheres to the fundamental permanent establishment regulation under Article 5(1).Furthermore, the agency provision becomes irrelevant if the enterprise has access to a physical place of business (available for use) or if it directly provides such facilities to the agent for their operations. It's crucial to note that an agency cannot be considered a permanent establishment if the agent fails to meet the criteria outlined in this paragraph.[54]

b)Subsidiary Permanent Establishment (Article 5(7)

The subsidiary of a company does not possess its distinct classification as a permanent establishment (PE). A subsidiary operates as an independent legal entity

[51] The paragraph does not include an agent whose activities are confined to auxiliary or preparatory activities listed under paragraph 4 of this Article, provided they do not form an essential or significant part of the activity of the enterprise.

[52] OECD Commentary: Article 5 para 34

[53] OECD Commentary: Article 5 para 33.1

[54] Arvid Skaar (n 49) 468.

distinct from its parent company. The establishment of a permanent establishment is not contingent on factors such as ownership, control, or affiliation among associated companies. In isolation, a relationship with the parent company or its subsidiaries does not automatically warrant classification as a PE. Moreover, the oversight or management exerted by the parent company does not in itself signify the existence of a permanent establishment.[55]

Under specific circumstances, a subsidiary can be deemed a permanent establishment, even if it doesn't act as an agent of the parent company solely due to share ownership. According to Article 5(1), a permanent establishment requires the availability of a physical place of business. Article 5(5) supplements this condition by establishing that an enterprise can be considered to have a permanent establishment even if it doesn't possess a physical location but conducts operations through an agent. Consequently, the parent company may have a permanent establishment if it conducts its business activities through a fixed place on the subsidiary's premises or if the subsidiary carries them out as a dependent agent.

Moreover, if the subsidiary acts as an independent agent for the parent company outside of its usual business operations, the parent company may be deemed to have a permanent establishment. For the subsidiary to meet the criteria of a permanent establishment, it must possess the authority to enter into contracts on behalf of the parent company and exercise this authority on a regular basis.[56] The same principles are applicable to tasks undertaken by other subsidiaries or in cases where the parent company serves as the permanent establishment for the subsidiary.

Exceptions to the PE definition

Article 5(4) outlines exceptions to the definition of a Permanent Establishment (PE), stating that preparatory and ancillary business activities or functions do not fall under the category of a permanent establishment. These activities, which are considerably removed from direct profit generation, pose challenges in attributing any profits to the specific fixed place of business. They are essentially unrelated to the revenue-generating activities they support. As per Article 5(4), all preparatory and auxiliary activities are exempt from taxation under PE.[57]Furthermore, Article 5(6) establishes that the engagement of a broker, a general commission agent, or an agent with independent status, as long as they are operating within the customary scope of their business or trade, does not qualify as a PE.[58]

UN Model Conevntion(UN MC)

The UN Model Double Taxation Convention between Developed and Developing Countries (UN MC) was first released in 1980 and underwent revisions

[55] OECD Commentary: Article 5 para 40
[56] OECD Commentary: Article 5 para 41
[57]'Article 5 Permanent Establishment | READ Online' (n 48).
[58]ibid.
[59]'United Nations Model Double Taxation Convention between Developed and Developing Countries' <https://digitallibrary.un.org/record/13957> accessed 7 October 2023.

in 2001.[59] It predominantly adopts the numbering system of the OECD Model Convention. However, it's important to note that significant disparities exist between the two models.[60]In contrast to the OECD Model Convention (OECD MC), which primarily emphasizes taxation based on residency, the United Nations Model Convention (UN MC) places a greater emphasis on taxation based on the source of income. The UN MC's Article 5 definition of permanent establishment includes the following additional criteria:The qualifying period for all construction-related permanent establishments is shortened to six months under Article 5(3)(a). This provision also specifies that an assembly project qualifies. Supervisory activities on a construction site or for a construction, assembly, or installation project that extend beyond six months also meet the criteria for a permanent establishment.

Article 5(3)(b) introduces the provision for the provision of services, including consulting services, by a company through its employees or other individuals. A permanent establishment arises if these services are provided by a company from a contracting country for a period or periods totaling more than six months within any 12-month period, either on the same project or a related one in the other jurisdiction. Simply providing a service may lead to taxation as a presumed 'service' permanent establishment, even if the company does not have a fixed base or place of business in that country as required by Article 5(1).[61]

Facilities used solely for the receipt and storage of goods or merchandise owned by the enterprise, as well as for maintaining a supply of goods or products exclusively for delivery, are not considered exempt activities under Article 5(4). In the OECD Model Convention, subparagraph (f) pertains to the exclusion of a fixed place solely for any combination of activities outlined in subparagraphs (a) to (e).Even in the absence of the ability to finalize contracts, a dependent agent who manages a stock of products or merchandise and routinely delivers them to the enterprise (referred to as a "stock agent") is deemed to be an agency permanent establishment according to Article 5(5)(b). According to the UN Commentary, this provision applies only if the sale of the goods is the result of any sales-related activities (such as advertising and promotion) conducted in the country on behalf of the resident, whether by the enterprise itself or by dependent agents. No permanent establishment arises if all sales-related activities occur outside the country and only the delivery is handled by an agent within the country.[62]

Furthermore, if transactions are not conducted at a fair market value, an independent agent conducting business in the usual course of their activities is considered an agency of a permanent establishment under Article 5(7) if their efforts are primarily or entirely on behalf of an enterprise. This means that the UN Model Convention specifies that the business and financial interactions between

[60] Bart Koster, United Nations Model Tax Convention and its Recent Developments (Asia Pacific Tax Bulletin, January, February 2004) p.4

[61] UN Commentary: Article 5, para 9-15.

[62] UN Commentary: Article 25, para 25.

the enterprise and the independent agent must deviate from what would typically occur between separate, independent entities for a permanent establishment to be recognized.[63]

Bilateral Tax Treaties

Most tax treaties are bilateral agreements that take into account the relative bargaining power and unique features of each contracting State's domestic tax systems, as well as the economic ties between them. Consequently, despite the existence of broadly accepted international models, tax treaties can vary significantly due to revisions agreed upon by the parties involved. It's important to note that the Model Convention (MC) and its commentaries do not hold legal binding force, unlike the negotiated treaty.[64] Each country's objective is to tax income generated within its borders based on factors like the source of the income, residency of the taxable entity, the existence of a Permanent Establishment, and so on. Double taxation can occur when two tax systems, each belonging to a specific country, come into play.[65] Tanzania has signed nine double taxation agreements since gaining independence, including treaties with Zambia, Italy, Denmark, Finland, Norway, Sweden, India, Canada, and South Africa. These agreements aim to attract investors from these countries by providing tax benefits, avoiding double taxation, and promoting trade.[66]

Additionally, there are motives such as promoting technology and skill transfers, as well as political considerations. Tanzania's bilateral tax agreements are influenced by both the OECD and UN Models, with a greater focus on the UN Models. However, the bilateral tax treaties of Tanzania, in particular, seem to be outdated and ill-equipped to address the challenges posed by the e-commerce and digital economy. These agreements traditionally require enterprises to be taxed in the jurisdiction where they have a physical presence.[67]

For instance, all of the aforementioned treaties mandate that business profits are subject to taxation only if the business maintains a "permanent establishment" in the country. On the contrary, e-commerce companies have found it relatively easy to avoid establishing a permanent presence in a country while still conducting substantial business and generating significant revenue. This is often achieved by large multinational corporations establishing offices in countries with lower corporate income tax rates. As a result, bilateral treaties have presented a paradox for the Tanzanian government. The absence of treaties specifically addressing the

[63] UN Commentary: Article 5, para 29-31.
[64] 'Coordination of Bilateral Tax Treaties / the OECD Model Tax Convention - OECD' <https://www.oecd.org/gov/regulatory-policy/taxtreaties-modeltaxconvention.htm> accessed 7 October 2023.
[65] DP Sengupta, 'India' in Claus Staringer and others (eds), *The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties* (Cambridge University Press 2012) <https://www.cambridge.org/core/books/impact-of-the-oecd-and-un-model-conventions-on-bilateral-tax-treaties/india/381095249EB8260A29623BCC86D056C2> accessed 7 October 2023.
[66] ECOSOC Resolution 1273 (XLIII) Tax Treaties between Developed and Developing Countries, 4 August 1967.
[67] For example see South Africa – Tanzania Income Tax Treaty (2005) Canada – Tanzania Income and Capital Tax Treaty (1995)

complexities of digital commercial transactions in Tanzania has allowed multinational corporations engaged in online business to engage in tax avoidance.

Judicial Interpretations of Permanent Establishment

Business Connection v Permanent Establishment

In the *Ishikawajima Harima Heavy Industries Ltd v Director of Income Tax*[68], the Supreme Court of India differentiated between Business Connection and Permanent Establishment. They stated that,"…in our opinion, the concepts of profits of Business connection and Permanent Establishment should not be mixed up. Whereas Business Connection is relevant for the purpose of application of Section 9; the concept of Permanent Establishment is relevant for assessing the income of a non-resident under DTAA."

The Supreme Court further explains that when establishing the presence of a Business Connection, one must refer to the established case laws under Indian Law. On the other hand, the concept of Permanent Establishment (PE) holds nearly identical definitions in all the Double Taxation Avoidance Agreements (DTAAs), as they are patterned after either UN or OECD Drafts. Therefore, even though not legally binding, the commentaries on these models should be consulted when dealing with PE assessments in domestic courts.

Residence v Permanent Establishment

In the Nigerian legal matter of *Offshore International S.A v Federal Board of Inland Revenue*,[69] the plaintiff requested a declaration from the court asserting that it was not obligated to pay taxes. The basis for this claim was that it did not qualify as a foreign company residing in Nigeria and did not have an office or any business presence within Nigeria.The court held that;"While there is no precise definition for a 'fixed base,' it should be considered akin to residence or ordinary residence. Simply being a non-Nigerian company and not having residency in Nigeria is not a valid argument for lacking a fixed base in Nigeria. The appellant's utilization of office facilities provided by another company in Nigeria (SPDC) makes it difficult to argue that the appellant did not have a fixed base in Nigeria at SPDC. Therefore, the courts' determination that the appellant had a permanent establishment in Nigeria was accurate."

In this case, the court focused on the concept of Permanent Establishment (PE), a fundamental principle in international tax law, rather than the notion of residency in domestic law. Furthermore, the differentiation between these concepts was clarified in the Ugandan legal case of *Target Well Control Uganda Limited* v *Commissioner General, Uganda Revenue Authority*.[70]The court believed that a Permanent

[68]*Ishikawajima Harima Heavy Industries Ltd v Director of Income Tax*, (2007) 288 ITR 408 (SC).
[69]Frc/1/36/175:2 All Nigerian Tax Cases 67
[70] HCCS 751 of 2015

Establishment plays a crucial role in determining tax liability on income within a jurisdiction. They also referenced the case of Nokia Networks v JCIT to support their stance. Additionally, in a commentary on Article 5(7) of the Model Convention, it was highlighted that meeting the criteria of physical or representative presence is essential for an entity to qualify as a Permanent Establishment. This contrasts with the perspective of residency under domestic law, which primarily focuses on physical presence. In the context of a Permanent Establishment, the evaluation may also consider representative presence or the establishment of a base for conducting the activities subject to taxation.

Conclusion

Therefore, Understanding PE is crucial in international taxation, as it determines when a foreign enterprise falls under a host country's tax jurisdiction. It also significantly impacts the taxation of multinational companies and the distribution of tax rights between countries. Our exploration began with a historical perspective, tracing the origins and development of the Permanent Establishment concept over time. We uncovered how this concept has evolved to address the challenges posed by cross-border trade and investment, reflecting the changing dynamics of the global economy. Understanding this historical backdrop is crucial for comprehending the motivations and objectives that underlie the current international tax landscape.Furthermore, we have provided an in-depth analysis of the Tanzanian perspective on Permanent Establishment. The Income Tax Act within Tanzania's legal framework delineates various types of Permanent Establishment, each with its own set of criteria and implications. These definitions and classifications are essential for businesses and tax authorities operating within Tanzania's borders, as they dictate the tax treatment of foreign enterprises with a presence in the country.

Importantly, it is noteworthy that Tanzania's definition of Permanent Establishment has not developed in isolation but has been influenced by international models, particularly the United Nations (UN) Model Convention on Double Taxation. The following article will delve into this influence and its practical implications for the interpretation and application of Permanent Establishment within Tanzania. The alignment with international models like the UN Model serves to harmonize tax regulations and facilitate cross-border trade while ensuring that countries can effectively tax income generated within their jurisdiction.Therefore, the analysis presented in this article underscores the pivotal role played by the Permanent Establishment concept in the field of international taxation. It illuminates the historical context, defines the Tanzanian perspective, and highlights the international influences that shape the country's approach to this concept. As we move forward, the subsequent article will provide further insights into the international dimensions of Permanent Establishment, examining its relationship with tax treaties and the broader implications for global taxation in an increasingly

interconnected world. By navigating these intricate topics, we aim to foster a deeper understanding of the complexities surrounding Permanent Establishment and its enduring significance in the realm of international taxation.

In summary, our examination of Permanent Establishment (PE) definitions in Model Conventions and Tanzania's bilateral treaties sheds light on the evolving landscape of international taxation. Tanzania's approach combines principles from both the OECD Model Convention (OECD-MC) and the United Nations Model Double Taxation Convention (UN-MC). However, it's clear that the UN-MC has gained prominence in bilateral treaties involving developing countries like Tanzania, marking a shift away from the OECD-MC, which primarily serves developed nations. This shift signifies Tanzania's deliberate effort to rebalance international taxation, prioritizing the interests of developing economies. It addresses historical challenges in protecting taxing rights and preventing tax erosion faced by nations like Tanzania due to the dominance of developed countries in shaping global tax standards. The UN-MC's focus on equitable taxation aligns with the needs of developing economies, making it a preferred choice for treaty negotiations. This transition reflects an awareness of the changing dynamics in global trade and investment. Tanzania's alignment with the UN-MC acknowledges the evolving nature of the global economy and the need for responsive tax treaties. This nuanced approach showcases Tanzania's strategic maneuvering in international taxation, safeguarding its interests while contributing to the broader trend among developing nations asserting their agency in global tax matters. This evolution signifies ongoing efforts to establish a fair and balanced global tax system, irrespective of a country's economic development level.