THE IMPACT OF REMOTE WORK ON THE CONCEPT OF 'PERMANENT ESTABLISHMENT'

by

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DECLARATION

I declare that this report is my own, unaided work. It is submitted in partial fulfilment of the requirements for the degree of Master of Laws (by Coursework and Research Report) s in the field of Taxation at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination in any other university.

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ABSTRACT

With the continuance of the remote working trend post the coronavirus disease, the traditional notion of ‘physical presence’ can be blurred, it is thus important to discuss how the tax principles applicable to the concept of ‘permanent establishment’ will be applied to remote workers. This research report investigates whether the presence or activities of a remote worker in South Africa are at risk of creating a permanent establishment in South Africa for a non-resident entity. This research report further examines whether the current permanent establishment concept in South Africa is sufficiently robust, and flexible, to accommodate challenges presented by remote work. To the extent that the South African concept is deficient, this research report will make recommendations regarding how it should be developed.

TABLE OF CONTENTS

1. INTRODUCTION

1.1. A brief overview of the international tax framework and the jurisdiction to tax

The principle of tax sovereignty is fundamental to the international taxation framework.[1] Sovereign states, such as South Africa ('SA'), possess the authority to govern and legislate within their own territories.[2] This concept underpins a country's capacity to levy taxes,[3] as each sovereign state enacts their own domestic tax laws. These domestic tax laws define, *inter alia*, their tax base, rates, and related administrative procedures.[4] A pivotal consideration in determining the allocation of taxing rights and the taxability of income within a jurisdiction is assessing whether a substantive connection exists between the income generated and the specific jurisdiction.[5]

Traditionally, most countries determine their jurisdiction to tax based upon the dual principles of residence and source.[6] Which is differentiated by the factors that are taken to determine the state's authority to tax income.[7] The residence basis of taxation relies on the existence of a significant connection between the taxpayer and the state, and demands income should be taxed in the state where the taxpayer is considered a tax resident.[8] In contrast, the source basis of taxation relies on the significant connection between the origin of income and the state, and demands income should be taxed in the state in which income originates, irrespective of the taxpayer's residence.[9] The concept of 'physical presence' plays a significant role in establishing taxing rights for the purposes of international tax.[10]

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[1] Peggy B Musgrave 'Sovereignty, Entitlement, and Co-operation in International Taxation' (2001) 26 *Brooklyn Journal of International Law* 1334 at 1341. Diane M Ring 'What's at Stake in the Sovereignty Debate?: International Tax and the Nation-State' (2008) 49(1) *Virginia Journal of Int' Law* 1 at 1.
[2] Lynette Olivier and Michael Honiball *International Tax: A South African Perspective* 5 ed (2011) 9.
[3] Ibid.
[4] OECD 'Addressing the Tax Challenges of the Digital Economy, OECD/G20 Base Erosion and Profit Shifting Project' available at *https://doi.org/10.1787/9789264218789-en*, accessed on 1 May 2024, 30-34.
[5] Olivier and Honiball op cit note 2 at 9-10.
[6] Ibid.
[7] Ibid. United Nations *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries* (2016) available at *https://www.un.org/esa/ffd/wp-content/uploads/2016/05/manual_btt.pdf*, accessed on 1 May 2024 at 1-3.
[8] Olivier and Honiball op cit note 2 at 9-10.
[9] Ibid at 11.
[10] Mzwandile Ngidi 'Determining "Permanent Establishment" in the Digital Economy EPOCH: A Case for South Africa' (2022) 43(3) *Obiter* 509 at 510.

The consequence of certain states adopting a residence-based taxation system while others utilize a source-based taxation system creates the opportunity for the same income to be taxed by multiple jurisdictions. This is the concept of 'double taxation'.[11] To alleviate the impact of double taxation, countries have adopted international tax treaties, which are a key component of international tax rules,[12] designed to standardize the treatment of cross-border taxation and mitigate the effects of international juridical double taxation,[13] by allocating taxing rights.[14]

1.2. 'Permanent establishment' as a concept and the significance of physical presence

The definition of "gross income" in section 1 of the Income Tax Act 58 of 1962 ('ITA') established tax jurisdiction for South African tax residents on the principle of residence. This means that tax residents of SA are taxed on their worldwide income.[15] Whereas a source basis of taxation has been implemented for non-residents.[16] Section 9 of the ITA codifies rules for determining when income is deemed to be from a source within SA,[17] and where section 9 does not provide for a certain scenario, the common law must be applied.

In respect of a company, residence in SA is established if the company has been 'incorporated, established or formed in the Republic' or if the company has its place of effective management ('POEM') in SA,[18] provided it is not deemed to be exclusively a resident of another country for purposes of a DTA.[19] Therefore, even if a company can demonstrate that its POEM is situated abroad, there could remain a tax exposure on the source basis, unless a double taxation

[11] Olivier and Honiball op cit note 2 at 9-10.
[12] Brian J Arnold 'An introduction to tax treaties' (2020) available at *https://financing.desa.un.org/document/introduction-tax-treaties-brian-arnold* , accessed on 1 June 2024, 1 at 1.
[13] Ibid. Rafał Mańko 'Suspension and expulsion of states from international organisations' (2023) available at *https://www.europarl.europa.eu/RegData/etudes/BRIE/2023/751410/EPRS_BRI(2023)751410_EN.pdf*, accessed on 1 June 2024. Olivier and Honiball op cit note 2 845. M Stinglingh (ed), AD Koekemoer, L van Heerden, Jas Wilcocks and P van Zwan *Silke: South African Income Tax* (2024) 871-872 § 21.4.
[14] Stinglingh (ed) Ibid at 875 § 21.4.3.
[15] Jean du Toit (ed) and Tax Consulting South Africa *Expatriate Tax: South African Citizens Working Abroad and Foreigners in South Africa* 2 ed (2019) 64-65.
[16] Section 1 of the Income Tax Act 58 of 1962.
[17] Section 9 of the of the ITA.
[18] Section 1 of the ITA.
[19] AW Oguttu 'Resolving double taxation: the concept of 'place of effective management' analysed from a South African perspective' (2008) 41(1) *Comparative and International Law Journal of South Africa* at 82.

agreement ('DTA') is applicable. Similarly, non-resident employees working in SA will be taxed on a source basis,[20] unless an exemption in terms of a DTA applies.[21]

Article 7 of Organisation for Economic Co-operation and Development ('OECD') Model Tax Convention ('OECD MTC') [22] addresses the taxation of business profits and establishes that business profits 'will only be taxable in the resident state, unless the enterprise carries on a business in the source state through a permanent establishment'.[23] Importantly, section 1 of the ITA defines a 'Permanent Establishment' ('PE') as defined from 'time to time in Article 5 of the OECD MTC. Article 5(1) of the OECD MTC outlines the broad definition of a PE as a 'fixed place of business through which the business of an enterprise is wholly or partly carried on'.

Consequently, in the treaty context, a non-resident taxpayer may only be taxed in the source state on the business profits that are attributable to a PE) situated in the source state.[24] As such, a PE is particularly relevant in relation to the source basis of taxation. Accordingly, the PE concept is integral to the interpretation and application of a DTA as it functions as the threshold for allocating taxing rights between contracting states. [25]

Following from the above, the relationship between source rules and the concept of a PE must be understood sequentially. In the context of a PE, and with respect to South African law, the nexus for taxation is first established through domestic source rules. Where both South Africa and another jurisdiction assert taxing rights on the same income (creating a situation of double taxation), the application of a DTA becomes necessary. Within that treaty framework, the PE requirement does not itself impose tax, but instead serves as a juridical allocation mechanism, determining which of the contracting states may tax the business profits of a non-resident

[20] Ibid.
[21] Article 15(1) and 15(2) op cite note 22 at M-47.
[22] OECD, *The Organisation for Economic Co-operation and Development Model Tax Convention on Income and on Capital* (2017) (Full Version) available at *https://doi.org/10.1787/g2g972ee-en*, accessed 1 June 2023 at M-19.
[23] Ibid at M-27.
[24] AW Oguttu 'The challenges of taxing profits attributed to permanent establishments: a South African perspective' (2009) 21(5) *SA Mercantile Law Journal* at 787.
[25] Leonardo F.M Castro 'Problems Involving Permanent Establishments: Overview of Relevant Issues in Today's International Economy' (2012) 2(2) *Global Business Law Review* 125 at 126.

enterprise and to what extent. In this way, the PE concept builds on, rather than replaces, domestic source taxation.

1.3. The Coronavirus Disease and Remote Working

The Coronavirus Disease ('COVID-19'), first identified in Wuhan, China swept across the globe at an exponential rate posing an enormous threat to the health and wellbeing of millions around the globe.[26] The outbreak of the COVID-19 was characterised as a pandemic on 11 March 2020.[27] Consequently, many governments across the globe implemented travel restrictions, social distancing, quarantine measures, and lockdowns to minimize the spread of COVID-19.[28]

As a result of travel restrictions and lockdowns imposed by many governments, a disruption to international travel and normal business operations was triggered. Which in turn forced many businesses to close their offices and revisit their internal business operations through the implementation of work-from-home policies, requiring employees to work from home, and in locations outside the jurisdictions where their employers operated.[29]

Post the COVID-19 pandemic, a 'new normal' has slowly emerged with the continuance of remote working. The ubiquity of remote working has been enabled and facilitated by a host of new technologies, the global scarcity of critically skilled resources, and the personal preference for segments of employees to work remotely.[30] This new paradigm introduces significant challenges for determining a PE risk[31] for businesses since the traditional notion of physical presence can be blurred by remote work practices.

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[26] World Health Organization 'Coronavirus disease (COVID-19) pandemic' available at *https://www.who.int/europe/emergencies/situations/covid-19,* accessed on 8 February 2024.
[27] Ibid.
[28] National Library of Medicine 'The global impact of the coronavirus pandemic' available at *https://www.ncbi.nlm.nih.gov/pmc/articles/PMC7254014/,* accessed on 8 February 2024.
[29] Bloomberg Tax & Accounting 'Transfer Pricing Considerations for Remote Workforces' available at *https://www.bakermckenzie.com//media/files/insight/publications/2020/04/bloomberg-tax/baker-mckenzie_bloomberg_transfer-pricing-considerations-for-remote-workforces_4_8_20.pdf?la=en*, accessed on 8 February 2024.
[30] J Barrero, N Bloom, and S Davis 'Why Working from Home Will Stick' available at *http://dx.doi.org/10.2139/ssrn.3741644,* accessed on 9 February 2024.
[31] 'PE risk' in this research report broadly refers to the risk that a company conducting business in a foreign state may be considered by tax authorities as having a fixed base of operations within that jurisdiction.

1.4. Research objective

As a tax concept, a PE signifies a certain threshold of business activity conducted by an enterprise in a foreign state where it is not a tax resident.[32] The underlying nexus for taxation in South Africa is established under domestic law, but a PE determines the extent to which those taxing rights may be exercised under an applicable DTA.[33] Within the traditional concept of PE, a source state could, with relative ease, impose a taxing right on the income of a business enterprise of a resident state, as the traditional concept of PE is primarily based upon physical presence. However, the continuance of the remote working trend, accelerated by the COVID-19 pandemic, challenges the conventional interpretation of what constitutes a PE.

This research report aims to explore whether the presence or activities of remote workers in SA could establish a PE in SA. The research report will further examine the impact of remote work by considering the adequacy of the current legal framework in addressing these challenges and whether developments are necessary to accommodate the evolving nature of work in a post-pandemic world.

1.5. Research Question

This research report seeks to establish whether the activities of a remote worker in SA are at risk of creating a PE in SA for a non-resident entity? The analysis explores whether the increased prevalence of remote work, spurred by the COVID-19 pandemic, raises the risk of creating a PE under international tax law. Specifically, it examines if a home office used by remote employees could constitute a fixed place of business for a non-resident company, triggering tax obligations in SA.

The primary research question raises sub-questions for analysis. First, it is essential to identify and understand the different types of PE that exist. Second, are there challenges in identifying a PE in an orthodox situation? Lastly, with the rise of remote work practices, a critical question

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[32] Olivier and Honiball op cit note 2 at 335-336.

[33] Ekkehart Reimer 'Article 5. Permanent Establishment' in Ekkehart Reimer and Alexander Rust (eds) *Klaus Vogel on Double Taxation Conventions* Vol 1 5 ed (2022) 280-281. Alexander Trepelkov, Harry Tonino and Dominika Halka (eds) *United Nations Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries* (2013) available at *https://www.un.org/esa/ffd/publications/handbook-dtt.html*, accessed 1 August 2024 at 209. AW Oguttu op cit note 19 at 80.

arises as to whether South African law needs further development to address these modern business arrangements effectively, ensuring that the tax framework remains relevant and capable of addressing the nuances of remote work in cross-border contexts, and clarifying when the activities of employees in SA may give rise to a PE for a non-resident enterprise.

1.6. Research outline and roadmap

I have divided this research report into five main chapters. Chapter one introduces the research problem regarding whether the presence or activities of a remote worker in SA is at risk of creating a PE in SA for a non-resident entity. Chapter two will discuss and establish what a PE is in SA, with a particular focus on the OECD MTC and the Commentaries on the Articles of the Model Tax Convention in the Organisation for Economic Co-operation and Development Model Tax Convention on Income and on Capital ('OECD Commentary'). Chapter two will further analyse how a PE is created, how taxing rights are allocated, how double taxation is eliminated, and the interpretation of DTA's. The inadvertent challenges of creating a PE will also be highlighted. Chapter three will discuss whether the activities of a remote worker in SA is at risk of creating a PE in SA for a non-resident entity and whether SA law requires development to cater for remote work practices. In addition, certain recommendations will be provided under chapter four. Finally, chapter five will summarise the findings of the research by drawing together the observations of the previous chapters.

2. THE CONCEPT OF PERMANENT ESTABLISHMENT

2.1. The allocation of taxing tights and elimination of double taxation

Tax treaties are a key component of international tax rules,[34] and which countries conclude to avoid double taxation by allocating taxing rights.[35] In the context of SA, section 108(2) of the ITA confirms any international agreement, 'as contemplated in section 231 of' the Constitution of the Republic of South Africa, 1996 ('Constitution'), which has been approved by both

[34] Arnold op cit note 12 at 1.
[35] Stinglingh (ed) et al op cit note 12 at 875 § 21.4.3.

houses of Parliament and published in the Government Gazette, will 'have effect as if enacted in this Act.'[36]

Tax treaties are generally based either on the OECD MTC, or the United Nations Model Tax Convention[37] ('UNMTC').[38] When a PE is recognized under a DTA, the source state where the PE operates is granted the authority to tax the business profits generated by that establishment.[39]

DTA's act as specialized laws (*leges speciales*)[40] in relation to the domestic tax laws (*lex generalis*) of each state.[41] According to the principle '*lex specialis derogat legi generali*' (special law overrides general law), treaties take precedence over domestic tax laws effective at the time the treaties are implemented.[42] This principle in context of SA have been canvassed indirectly in case law, and according to I du Plessis, three distinct viewpoints are evident upon examining SA case law as to whether a DTA forming part of SA law, supersedes our domestic law.[43] However, for the purposes of this research report, a detailed analysis on this technicality will not be explored further; however, it is noted by I du Plessis that SA courts are likely to adopt the approach outlined in *Commissioner for the South African Revenue Service v Tradehold*,[44] as 'it was a unanimous judgment by the Supreme Court of Appeal.'[45] In this

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[36] Section 108(2) of the of the ITA.
[37] United Nations Model Double Taxation Convention between Developed and Developing Countries (2017), available at *https://doi.org/10.18356/cc8f6035-en*, accessed 30 July 2023.
[38] Arnold op cit note 12 at 4.
[39] The discussion which follows consider the customary wording set out in the OECD MTC only, an analysis of the UNMTC is out of the scope of this research paper.
[40] K Vogel 'Double Tax Treaties and Their Interpretation' (1986) 4(1) *Berkeley Journal of International Law* 1 at 26.
[41] International Fiscal Association *Tax Treaties and Domestic Legislation* Vol 14.6 (2016) 3-4. Klaus Vogel 'The Domestic Tax Law Perspective' in Guglielmo Maisto (ed) *Tax Treaties and Domestic Legislation* (2006) 3.
[42] Vogel Ibid. PILPG 'Lex Specialis Derogat Generali: Simultaneous (Complementary) Applicability of International Humanitarian Law and Human Rights' 9 June 2023, available at *https://www.publicinternationallawandpolicygroup.org/lawyering-justice-blog/2023/6/9/lex-specialis-derogat-generali-simultaneous-complementary-applicability-of-international-humanitarian-law-and-human-rights*, accessed on 1 August 2024. André Greeff *A Critical Analysis of the Interpretation of the term "Associated Enterprise" in provisions in South African Double Taxation Agreements based on Article 9 of the Organisation for Economic Cooperation and Development's Model Tax Convention on Income and on Capital* (unpublished LLM thesis, Stellenbosch University) at 18.
[43] I du Plessis 'Some thoughts on the interpretation of tax treaties in South Africa' (2012) 24(1) *SA Merc LJ* 31 at 39.
[44] *Commissioner for the South African Revenue Service v Tradehold Ltd* 2012 (3) SA 294 (SCA).
[45] du Plessis op cit note 43 at 41.

regard, it was held by the Supreme Court of Appeal that a DTA 'modifies domestic law'[46] and in the event of conflict, the DTA shall take precedence over domestic law.[47]

The Vienna Convention on the Law of Treaties[48] ('VCLT') establishes the rules governing the creation, interpretation and enforcement of international agreements.[49] SA has not ratified the VCLT. However, in *Krok v Commissioner for the South African Revenue Service*,[50] the SCA held in interpreting the provisions of a DTA, Articles 31 and 32 of the VCLT must be considered, as the VCLT is binding on SA as rules of customary international law.[51] Article 31(1) of the VCLT requires treaties be interpreted in accordance with the 'ordinary meaning to be given to the terms in the treaty in their context and in the light of its object and purpose'.[52] Article 32 of the VCLT stipulates recourse may be had to 'supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion'.[53] The Tax Court in *ITC 1878*,[54] confirmed the OECD Commentary may be utilized, as an aid in interpreting the provisions of a DTA, where a DTA contains the same article as the OECD MTC.[55]

For the purposes of this research report, a further discussion on the interpretation of a DTA is not relevant, save to note the significance of this interpretive framework is that it shapes how South African courts will approach the interpretation of PE provisions in DTAs in the context of remote work. In this regard, the Tax Court in *ABC (Pty) Ltd v CSARS*[56] confirmed that while DTAs have the force of statute under section 108 of the ITA, they remain treaties in nature and must be interpreted in accordance with the ordinary meaning of their terms, context, and purpose, as required by the VCLT. The Court stressed that interpretation is a matter of law, not fact, therefore, extrinsic evidence of subjective intention or negotiation history is inadmissible,

[46] du Plessis op cit 43 at 39.
[47] Tradehold op cit note 44 para 16-17.
[48] Vienna Convention on the Law of Treaties (1969), 1155 UNTS 331.
[49] Werner Haslehner 'Introduction' in Ekkehart Reimer and Alexander Rust (eds) *Klaus Vogel on Double Taxation Conventions* Vol 1 5 ed (2022) 33.
[50] *Krok v Commissioner for the South African Revenue Service* 2015 (6) SA 317 (SCA) para 27.
[51] Section 232 of the Constitution.
[52] VCLT op cit note 48.
[53] VCLT op cit note 48.
[54] *ITC 1878* 2015 (77) SATC 2.
[55] Ibid para 14-15,
[56] *ABC (Pty) Ltd v CSARS* 2019 JOL 46057 (TC) para 19, 27-30, 66-69.

and courts are bound by the treaty text itself, even if this leads to fiscally adverse consequences.[57]

2.2. Understanding the key concepts of a permanent establishment

The current definition of a PE in SA's domestic legislation is based on the definition developed by the OECD. Article 5 of the OECD MTC is relevant for the application of Article 7 of the OECD MTC. A detailed analysis of Article 7 of the OECD MTC is beyond the scope of this research report.

2.2.1. The taxation of business profits

Article 7(1) of the OECD MTC confirms profits of an enterprise shall only be taxed in the resident state, unless the enterprise carries on business in a source state through a PE.[58] When an enterprise carries on business through a PE in a source state, the source state will have the right of taxation over the business profits of that enterprise which are attributable to the PE.[59]

2.2.2. The definition of permanent establishment

Article 5(1) of the OECD MTC outlines the broad definition of a PE as a 'fixed place of business through which the business of an enterprise is wholly or partly carried on'.[60]

Article 5(2) of the OECD MTC provides specific inclusions under the definition of a PE, listed under sub-paragraphs (a) to (f),[61] which are *prima facie* indicative of the existence of a PE.[62] However, these specific inclusions must be evaluated against the fundamental criteria of a PE outlined in Article 5(1) of the OECD MTC,[63] as the mere presence of a specific inclusion (such

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[57] Ibid.
[58] OECD op cit note 15 at M-27.
[59] Ibid.
[60] Ibid at M-19.
[61] Ibid.
[62] Robert L Williams *Fundamentals of Permanent Establishments* (2014) 54.
[63] OECD op cit note 15 at C(5)-18 para 45.

as a factory) belonging to a non-resident in the source state would not, in itself, be sufficient to establish a PE.[64]

Article 5(3) of the OECD MTC provides a building site, construction or installation project will only constitute a PE if it lasts more than twelve months.[65]

As noted by Ekkehart Reimer, Article 5 contains positive and negative examples as to what constitutes a PE.[66] Article 5(4) of the OECD MTC provides exemptions (negative examples) listed under sub-paragraphs (a) to (f) to what constitutes a PE.[67] Activities which are auxiliary or preparatory in nature to an entity's business will not render the entity having a PE in the source state.[68] The activities involved in purchasing, processing contracts, storing, displaying, or delivering a company's goods are specifically recognized as exempt from certain regulations.[69]

The Supreme Court of India's decision in *Union of India v U.A.E Exchange Centre*,[70] addressed the tax implications of activities conducted by a liaison office of a UAE Exchange Centre in India.[71] The central legal issue was whether the respondent's liaison office in India constituted a PE under Article 5 of the DTA between India and the UAE, and whether the liaison offices' activities in India had crossed the threshold of performing auxiliary services under Article 5(3)(e) of the DTA.[72] The liaison office in India was approved by the Reserve Bank of India under strict conditions to provide remittance services,[73] and their permitted activities included responding to inquiries from correspondent banks, reconciling bank accounts in India, transmitting payment instructions, and printing Indian Rupee drafts.[74] The

[64] Williams op cit note 62 at 55.
[65] Article 5(3) op cit note 15 at M-19 and M-20. Known as 'Project PE' per Castro op cit note 25 at 127.
[66] Reimer op cit note 33 at 282.
[67] Article 5(4) op cit note 15 at M-20.
[68] Reimer op cit note 33 at 255.
[69] Williams op cit note 62 at 183.
[70] *Union of India v U.A.E Exchange Centre*, Civil Appeal No. 9775 of 2011, (2020) 107 CCH 0426 ISCC. In the absence of SA jurisprudence, foreign jurisprudence on the interpretation of similar provisions is instructive in determining contextual meaning per *Sanderson v Attorney-General*, Eastern Cape 1998 (2) SA 38 (CC) para 26, where the Constitutional Court considered the admissibility of foreign jurisprudence in South African law, and it held that '[c]omparative research is generally valuable and is all the more so when dealing with problems new to our jurisprudence but well developed in mature constitutional democracies'.
[71] *Union of India v U.A.E Exchange Centre* Ibid para 1-6.
[72] Ibid para 1-6 and 7-8.
[73] Ibid para 1-3.
[74] Ibid para 2.

Reserve Bank of India explicitly prohibited the office from engaging in any commercial, trading, or industrial activities.[75] The Supreme Court examined the nature of the activities permitted by the Reserve Bank of India and their alignment with the provisions of the DTA. It noted that the Reserve Bank of India's permission was limited to activities of a preparatory or auxiliary character, explicitly prohibiting any commercial or trading activities.[76] The Court referred to Article 5(3)(e) of the DTA, which states that a fixed place of business solely for activities of a preparatory or auxiliary character does not constitute a PE.[77] Given that the liaison office's activities were preparatory or auxiliary, the Court concluded that it did not constitute a PE in India.[78]

Article 5(5) of the OECD MTC explains the concept of a dependant agent PE, and highlights identifying criteria,[79] broadening the scope of the PE concept. Where company may not hold a fixed place of business in another state, it may still be treated as having a PE if it meets the provisions of Article 5(5) of the OECD MTC. Article 5(6) – 5(8) are not relevant for the purposes of this research report. I will discuss Article 5(5) in greater detail in the next section of this research report.

2.3. The different ‘types’ of permanent establishment

2.3.1. Physical permanent establishment[80]

As noted, a simple explanation of a PE is a ‘fixed place of business through which the business of an enterprise is wholly or partly carried on’.[81] The OECD Commentary provides an expansion on the elements of the definition of a PE under Article 5(1) of the OECD MTC, in which the conditions discussed are outlined.[82] According to Arvid Skaar, the ‘fixed place of business test’ involves several interrelated criteria for determining a PE, and which are discussed below. [83]

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[75] Ibid para 9.
[76] Ibid para 25-30 and 33-35.
[77] Ibid para 14.
[78] Ibid para 11, 14.
[79] OECD op cit note 15 at M-20.
[80] Williams op cit note 62 at 16.
[81] Article 5(1) of the OECD op cit note 15 at M-19.
[82] Williams op cit note 62 at 15-16.
[83] Arvid Aage Skaar *Permanent Establishment: Erosion of the Tax Treaty Principle* 2 ed (2020) 95.

2.3.1.1. *Situs* test

The existence of a place of business refers to a physical place,[84] such as an office or branch,[85] designated for conducting business activities.[86] Therefore, it refers to tangible assets[87] which are at the disposal of an entity, and necessary for the business to carry out their business enterprise.[88]

2.3.1.2. The place of business must be fixed[89]

The term 'fixed' must be understood in two distinct aspects: first, it refers to a specific geographical location (*locus* test) which pinpoints the precise spot where commercial operations are carried out.[90] Second, it includes a fixed duration of those activities (*tempus* test), which considers the period over which the business operations are sustained.[91]

2.3.1.2.1. *Locus* test

According to Arvid Skaar, the locus (location) test establishes a clear connection between the place of business and a specific geographical location,[92] which should be sufficiently fixed.[93] This implies a degree of permanence tied to the specific geographical location, ensuring that the fixed place of business is not transitional for jurisdictional purposes.[94] For example, and as referred to in the OECD Commentary, a satellite would not qualify as a PE as it is not tied to a identifiable territory.[95] In cases where business activities may involve movement to conduct

[84] Olivier and Honiball op cit note 2 at 336-338. OECD op cit note 15 at C(5)-3 para 6. Balazs Karolyi *The Challenges of Permanent Establishment Concept and the Response of BEPS Actions* (unpublished LLM Thesis, Tilburg University, 2017) 23-25.
[85] Article 5(2) op cit note 15 at M-19.
[86] OECD op cit note 15 at C(5)-3 para 6, C(5)-4 para 10, C(5)-5 para 11.
[87] Ibid at C(5)-12 para 36.
[88] Williams op cit note 62 at 16-17.
[89] OECD op cit note 15 at C(5)-3 para 6.
[90] Olivier and Honiball op cit note 2 at 337-338. OECD op cit note 15 at C(5)-3 para 6.
[91] Ibid.
[92] Skaar op cit note 83 at 109.
[93] Olivier and Honiball op cit note 2 at 337. Williams op cit note 62 at 16 and 20. OECD op cit note 15 at C(5)-7 and C(5)-8 para 21.
[94] OECD op cit note 15 at C(5)-3 para 6, C(5)-7 to C(5)-8 para 21.
[95] Ibid at C(5)-3 para 6, C(5)-9 para 27.

operations (mining industries or outdoor markets), the business can still be considered to have a fixed place of business, where the nature of the activities involves mobility.[96]

In *Formula One World Championship Ltd v Commissioner of Income Ta*x,[97] the Supreme Court of India addressed the taxability of payments under a Race Promotion Contract entered into on 13 September 2011, between the Formula One World Championship Ltd[98] and Jaypee Sports International Ltd, which granted exclusive rights to host the Formula One Grand Prix of India for a payment of USD 40 million.[99] The key issues revolved around whether the Formula One World Championship Ltd had a PE in India, and whether the payments were taxable as business income in India.[100] Initially, the Authority for Advance Rulings ruled that the payments were royalty payments under the DTA, but held that Formula One World Championship Ltd did not have a PE in India.[101] The Delhi High Court reversed this finding, concluding that Formula One World Championship Ltd had a PE in India and that the payments were taxable as business income attributable to the PE.[102]

On appeal to the Supreme Court, emphasized its Formula One World Championship Ltd.'s control over the Buddh International Circuit in their reasoning which was exclusively used for the event during the race period, albeit for a short duration of time.[103] The Court concluded that this arrangement constituted a 'fixed place of business' under Article 5 of the DTA, as the Formula One World Championship Ltd exercised substantial operational control over the circuit facilities.[104] The judgment provides insight into the determination of a PE, demonstrating that the threshold for a fixed place of business can be met through temporary but meaningful control over a location.

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[96] Ibid at C(5)-8 para 23.
[97] *Formula One World Championship Ltd v Commissioner of Income Ta*x (2017) 15 SCC 602.
[98] Ibid para 9.
[99] Ibid para 1-3
[100] Ibid.
[101] Ibid para 3.
[102] Ibid paras 4, 41-43.
[103] Ibid paras 6, 67-76.
[104] Ibid paras 7-9, 67-76.

2.3.1.2.2. *Tempus* test

The tempus test provides that the place of business must be utilized for a certain duration of time.[105] Closely linked to the *locus* test, both tests emphasize the need for a stable and continuous business operation tied to a physical location,[106] ensuring the enterprise is not merely transient.[107] The *tempus* test does not specify an exact time period; however, it is accepted that business activity lasting a minimum of six to twelve months can meet this criterion.[108]

However, there are two exceptions to this criterion. The first applies when business activities are recurring.[109] In such cases, each period of use and the frequency of operations must be examined, ensuring sporadic activities do not inadvertently qualify as permanent solely based on their recurrence.[110] The second exception being that a PE may exist if business activities occur in a country, for a short duration, with the key factor being the nature and extent of the business activities, rather than just their duration. [111]

2.3.1.3. For a fixed place of business to constitute a PE, the business of the enterprise must be wholly or partly carried on there,[112] which requires consideration of two distinct aspects:

2.3.1.3.1. The right of use over the fixed place of business

The taxpayer must have a certain degree of control over the fixed place of business. Ownership is not a determining factor, and a place of business may exist where the site is rented, or established in the business facility of another enterprise, with the specific condition being that it must be 'at the disposal' of the non-resident enterprise.[113] The interpretation of 'at the disposal' of, implies a certain level of control. Per Arvid Skaar, the 'right of use test' is integral

[105] Skaar op cit note 83 at 138.
[106] OECD op cit note 15 at C(5)-10 para 28. Skaar op cit note 83 at 195.
[107] Williams op cit note 62 at 24.
[108] OECD op cit note 15 at C(5)-10 para 28-29. Olivier and Honiball op cit note 2 at 338-339.
[109] Skaar op cit note 83 at 202. OECD op cit note 15 at C(5)-10 para 29
[110] OECD Ibid.
[111] Ibid at C(5)-10 para 30.
[112] Ibid at C(5)-3 para 6.
[113] Ibid at C(5)-5 para 10.

to defining a PE under tax treaties, focusing on the connection between an enterprise's business activity and the place of business. It establishes that the business activity must be conducted 'through' a fixed place of business, with the enterprise holding control or rights over that location.[114]

The OECD Commentary does not define the notion of 'at the disposal', [115] and its precise scope remains debated due to conflicting judicial interpretations. Per Arvid Skaar, rather than providing a detailed analysis, the OECD Commentary opts instead to provide examples that highlight the concept's variability depending on the nature of the business.[116] Arvid Skaar further draws a clear distinction between a legal right of use and a factual right of use.[117] A legal right of use allows a taxpayer to access a location without unilateral termination, requiring agreed procedures for revocation. [118] In contrast, factual use involves utilizing premises without formal rights and can be terminated without notice.[119] This denotes that while legal or factual control indicates the degree of access an enterprise has to premises, the test of whether those premises are 'at the disposal' of the enterprise depends on their functional use in carrying out the core business with sufficient permanence, and which is expanded upon below.

Per the OECD Commentary, the concept of 'effective power'[120] is important when considering if a location is 'at the disposal' of an enterprise.[121] A painter who worked three days a week for two years in an office building owned by their primary client is one example given by the OECD Commentary.[122] The OECD Commentary concludes the painter who is performing the most important function of the business, establishes a PE.[123] Per Arvid Skaar, the OECD's interpretation of the painter example represents a shift in focus from the taxpayer's control over a place of business to the nature of the business activity conducted there.[124] This shift

[114] Skaar op cit note 83 at 138.
[115] Article 3(2) of the OECD MTC confirms any term not defined in the DTA will bear the meaning 'under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State'.
[116] Skaar op cit note 83 at 138.
[117] Ibid.
[118] Ibid.
[119] Ibid.
[120] Ibid C(5)-5 para 12 and C(5)-14
[121] OECD op cit note 15 at C(5)-4 para 10, C(5)-5 para 12. Thanissorn Masuchand *Does the taxation of a permanent establishment ensure source-based taxation on business profits? An analysis of cross-border services* (unpublished LLM thesis, Lund University, 2018) at 17.
[122] OECD Ibid C5(5)-6 para 17
[123] Ibid.
[124] Skaar op cit note 83 at 144.

challenges traditional interpretations of the 'right of use test' because the OECD's approach implies that the defining factor for establishing a PE is the nature, duration, and consistency of the activities performed, rather than the taxpayer's explicit control over the location.[125]

In contrast, the Bundesfinanzhof considered whether a Dutch company operating in Germany constituted a PE under German tax law.[126] The Dutch company provided cleaning services for NATO aircraft at a military airport in Germany, working as a subcontractor to NATO's main contractor.[127] The main question was whether the Dutch company had a fixed place of business at the NATO airbase, thereby establishing a PE. The court concluded that the Dutch company did not establish a PE in Germany, on the basis that despite having access to, and utilizing various facilities within the airbase, the Dutch company had no legal right to the base itself and utilized it under authorization.[128] Thereby, the court emphasized the necessity of having 'legal possession of', or 'control' of a location to establish a PE.

In the Canadian case of *Canada v Dudney,* the Tax Court decided Mr. Dudney did not have control over the office space, which he could only use for limited purposes. Therefore, he did not have a PE in Canada.[129] This clarified that mere access to a premise does not constitute a PE, and for a PE to exist, the non-resident must have 'effective control' over the premises.

2.3.1.3.2. Business activity test

The business activities of the enterprise must be conducted through the fixed place of business.[130] This business activity can be core to the operation or of a supporting nature, as long as it goes beyond preparatory or auxiliary functions.[131] This distinction is vital for determining whether a PE exists, and thus whether a non-resident enterprise becomes taxable in a source state.[132] The differentiation is anchored in the 'negative list' of the OECD model

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[125] Ibid.
[126] Bundesfinanzhof, IR 30/07 (2008), available at *https://datenbank.nwb.de/Dokument/307445/?query=Bundesfinanzhof,%20IR%2030%2F07&listPos=3,* accessed on 2 February 2024. An unofficial translation can be obtained from this website. Skaar op cit note 83 at 140.
[127] Ibid.
[128] Ibid.
[129] *Canada v Dudney* (2000) DTC 6169 (FCA) paras 10-15.
[130] Olivier and Honiball op cit note 2 at 340
[131] OECD op cit note 15 at C(5)-6 para 18, C(5)-26 para 62 and C(5)-51-52 para 130.
[132] Skaar op cit note 83 at 245

treaty, which exempts specific activities from constituting a PE.[133] While the negative list provides exemptions, these are conditional on the qualitative and quantitative significance of the activities within the enterprise's overall operations.[134]

2.3.2. Service Permanent Establishment

The concept of a ‘service PE’ is introduced in the OECD Commentary, it is notably not defined in the OECD MTC.[135] This omission arguably raises concerns regarding the function of the OECD Commentary which is intended to be utilized as an integratory mechanism and provide clarification of the provisions of the OECD MTC. In contrast, the UNMTC approach provides more flexibility to the source state, allowing it to tax income from services provided by non-resident enterprises by explicitly defining a service PE.[136] Under, Article 5(3)(b) of the UNMTC, a service PE is established when a non-resident enterprise provides services, through its employees in a source state for more than 183 days in any 12-month period.[137] This threshold acknowledges that services can have a substantial economic presence without a fixed location.

The 2017 revision of the UNMTC made a key change to Article 5(3)(b) by removing the phrase ‘for the same or a connected project’.[138] This broadened the scope of a Service PE and closed loopholes, preventing the artificial division of projects to avoid exceeding the time threshold, aligning with the regulation against ‘splitting up contracts’ as provided for in the final OECD Report relating to Action 7of the Action Plan on Base Erosion and Profit Shifting.[139]

The examples illustrated below illustrate how jurisdictions navigate the concept of a service PE in light of varying international frameworks. The Saudi Arabian Zakat Tax and Customs

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[133] Ibid.
[134] Skaar op cit note 83 at 245.
[135] OECD op cit note 15 at C(5)-59-C5-60 paras 154-158.
[136] Article 5(3)(b) of the UNMTC op cit note 37.
[137] Ibid.
[138] OECD, ‘Action Plan on Base Erosion and Profit Shifting’ (2013) available at *https://doi.org/10.1787/9789264202719-en*, accessed on 1 January 2024. Committee of Experts on International Cooperation in Tax Matters ‘Proposed Base Erosion and Profit-Shifting Related Changes to the United Nations Model Double Taxation Convention between Developed and Developing Countries’ E/C.18/2017/CRP.7 (2017) available at *https://www.un.org/esa/ffd/wp-content/uploads/2017/02/14STM_CRP7_BEPS.pdf*, accessed on 1 June 2024.
[139] OECD, OECD/G20 Base Erosion and Proft Shifting ‘Project Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7: 2015 Final Report’ (2015) available at *https://doi.org/10.1787/9789264241220-en.*, accessed on 1 January 2024, pg. 42-43.The final report for BEPS Action 7 was released in 2015, with the primary goal of addressing artificial tax avoidance circumventing PE status by closing loopholes.

Authority issued a Circular[140] clarifying the application of service PE under Saudi Arabia's DTA.[141] Per the Circular, for a service PE to exist, the non-resident enterprise must have employees physically present in Saudi Arabia for more than 183 days in a 12-month period.[142] Importantly, it excludes remote services provided from abroad, which aligns with the traditional understanding of physical presence as a criterion for PE.[143] In India, the Delhi Income Tax Appellate Tribunal ruled that for a services PE to exist, employees of a foreign company must be physically present in India in accordance with the time threshold based upon the India-Singapore DTA.[144] Further, no virtual service PE is applicable as this is not provided for in the DTA.[145]

2.3.3. Agency Permanent Establishment

Article 5(5) of the OECD MTC introduces agency PE. Under this provision, if the criteria in Article 5(5) are met, an enterprise is deemed to have a PE through the actions of a dependent agent, without the need to assess the traditional elements of the traditional PE concept, such as a fixed place of business. [146]

Per article 5(5) of the OECD MTC where a dependant agent habitually[147] concludes contracts of behalf of a company in a source jurisdiction (or under their own name but the contracts involve either the transfer or use of property owned by the non-resident enterprise, or the provision of services by the enterprise)[148] a PE the source country can arise. Subject to the agent's activities not being preparatory or auxiliary in nature and the contracts are central to

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[140] Zakat Tax and Customs Authority 'Circular Taxation of Permanent Establishments in the context of Double Taxation Agreements' Publication Number 2303001 (17 May 2023) available at *https://zatca.gov.sa/en/MediaCenter/Publications/Documents/Taxation%20of%20Permanent%20Establishments.pdf,* accessed on 1 August 2024.
[141] Ibid.
[142] Ibid.
[143] Ibid.
[144] *Clifford Chance Pte Ltd, Singapore v Assistance Commissioner of Income Tax* ITAT (March 2024) available at *https://indiankanoon.org/doc/86353860/*, accessed on 1 August 2024.
[145] Ibid paras 12.1, 12.4, 12.5, and 12.7. This concept that a virtual service PE can be challenged if a tax treaty does not make specific provision for this was confirmed by the OECD in their Interim Report. OECD/G20 Base Erosion and Profit Shifting Project 'Tax Challenges Arising from Digitalisation – Interim Report 2018' (16 March 2018) available at *https://doi.org/10.1787/9789264293083-en,* accessed on 1 August 2024, 139 para 354. For the purposes of this research report an in-depth analysis of the concept of a virtual PE is out of the scope.
[146] Olivier and Honiball op cit note 2 at 345.
[147] OECD op cit note 15 at C(5)-6 para 18 and C(5)-41 para 97. This mirrors the underlying principles in Article 5 of the OECD MTC, as a central item is the frequency of the activities, and that this is not merely transitory.
[148] Article 5(5)(b) and (c) Ibid at M-20.

the enterprises business[149] (this is 'determined on the basis of the commercial realities of the situation').[150] Article 5(6) of the OECD MTC specifies an agent acting independently in the ordinary course of their business will not create a PE. In other words, when an independent agent operates autonomously and not under the control of the enterprise, a PE does not arise. However, this exemption does not apply if the agent exclusively or nearly exclusively acts on behalf of a non-resident or closely related enterprise.[151]

3. REMOTE WORK AND PERMANENT ESTABLISHMENT RISKS

3.1. Can a home office create a fixed Permanent Establishment?

The rise of remote work has transformed how businesses operate, raising complex questions regarding the concept of a PE. Central to this question is whether an employee's home office can be considered a fixed place of business at the disposal of the employer, thereby constituting a PE. This is particularly pertinent in SA, which encourages foreign individuals to work remotely via the Second Amendment to the Immigration Regulations, 2024, which introduced a digital nomad visa.[152]

A notable case in point is the binding ruling ('Ruling') issued by the Danish Tax Council ('DTC') which concluded that a home office in Denmark constituted a PE.[153] A German company ('employer') employed a sales manager ('employee'), whose role involved sales and business development across various regions. The employee's role was limited to establishing initial contact with customers, but the negotiation and conclusion of agreements occurred at the employer's head office in Germany. The employee had authority to confirm orders within a pre-determined price range, and any significant deviation from the established price range required approval from the employer. The employee resided in Denmark for personal reasons being he did 'not wish to move to Germany', nor did 'he wish to commute between Denmark

[149] Article 5(5) Ibid at M-20, C(5)-6 para 18 and C(5)-41 para 97.
[150] Ibid.
[151] Ibid at at M-20.
[152] Second Amendment of the Immigration Regulations, 2014 in GN R4847 *GG* 50675 of 20 May 2024.
[153] SKM2022.250.SR related to case number 21-0722131 (26 April 2022) available at *https://info.skat.dk/data.aspx?oid=2350336* (12 May 2022) accessed on 1 January 2024. An unofficial translation can be obtained from this website.

and Germany'.[154] The employer agreed the employee can 'perform his work from his place of residence in Denmark to the extent the work does not require the employee's presence elsewhere'.[155] Notably, the employees' employment contract with regards to his place of work stated that: '[t]he employee's place of work is with the customers and at his private address (home workplace)'.[156]

The employer argued that the employee's work in Denmark did not constitute a PE, citing several factors. First, the employee's presence in Denmark was for personal reasons and did not serve any commercial purpose. Additionally, whilst the employee worked from Denmark, the employer claimed it did not derive any benefit from this arrangement, and that the work performed in Denmark was neither essential, nor core to its business operations.[157] However, key points in the DTC's reasoning for its Ruling highlighted that the employee's role in developing the Nordic market had independent commercial value.[158] Moreover, the employee's home office in Denmark was utilized continuously over an extended period, with 40-50% of their employment duties being carried out there. [159] The employee's tasks were integral to the business and not merely preparatory or auxiliary, as their role actively expanded the customer base and aligned with the employer's strategic interest in Denmark. Demonstrating the Employer benefited from the employee's presence in Denmark, akin to having an office in the country.[160]

It is noted that the Ruling does not explicitly mention the concept of 'effective control', it alludes to it by noting the employee's employment contract not providing for an alternate place of work, implying the home office is 'at the disposal' of the employer.[161] The Ruling further drew on the OECD Commentary to support this reasoning, emphasizing the relevance of effective control in determining whether a home office constitutes a PE.[162]

[154] Ibid.
[155] Ibid.
[156] Ibid.
[157] Ibid.
[158] Ibid.
[159] Ibid.
[160] Ibid.
[161] Ibid.
[162] Ibid.

In *George Simenon v Commissioner,*[163] the Tax Court in America held an author's home office was a fixed place of business, constituting a PE.[164] The court reasoned the author's activities were regular and substantial enough to constitute a business carried on from his home office.[165] Based on my review of the aforementioned sources, I conclude that this concept directly corresponds with the principles outlined in the Ruling, which determined that an employee's home office constituted a PE due to the continuous and significant business activities carried out from that location.

Belgium and the Netherlands concluded an agreement ('Agreement'), on the interpretation of Article 5 of their DTA regarding the establishment of a PE in the cases remote working.[166] The Agreement three key scenarios, including incidental homeworking, which does not constitute a PE as it lacks permanence and is temporary in nature.[167] In cases of structured homeworking where employees have the option to work elsewhere, a PE may arise if the home office is used systematically at the employer's request.[168] However, voluntary homeworking without any obligation typically does not result in a PE.[169] Finally, structured and mandatory homeworking leads to the establishment of a PE if the employer exercises effective control over the home office, either through explicit obligations or the absence of alternatives, thereby demonstrating the employer's disposal over the home office.[170] The Agreement offers practical guidelines, including the '50% or less' rule, suggesting if an employee works from home for less than half of their time over a 12-month period, a PE will not be triggered.[171] Additionally, the exception for preparatory or auxiliary activities being performed will prevent PE recognition under the DTA.[172]

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163 *Georges Simenon v Commissioner*, 44 T.C. 820 (1965) available at *https://casetext.com/case/simenon-v-commr-of-internal-revenue,* accessed on 8 August 2024. Williams op cit note 62 at 56.
164 Ibid.
165 Ibid.
166 Peter Moreau 'Will home working employees trigger a permanent establishment for the foreign employer?' available at *https://www.ey.com/en_be/tax/tax-alerts/2024/will-home-working-employees-trigger-pe-agreement-between-be-nl-published,* accessed on 1 June 2024. For further details, refer to the official publications of this agreement published in the Belgian Official Gazette on 12 December 2023 available at *https://www.ejustice.just.fgov.be/cgi/welcome.pl*, accessed on 1 June 2024.
167 Ibid.
168 Ibid
169 Ibid.
170 Ibid.
171 Ibid.
172 Ibid.

The Austrian Ministry of Finance issued EAS 3445 Ruling ('EAS') on 10 July 2023,[173] wherein it denied the qualification of a home office as a PE (when a non-executive employee works two days a week from home and three days from the employer's premises in Germany) as working from home was not required by the employer. Thereby the employer did not have *de facto* control over the home office.[174] In accordance with the EAS, no PE will exist with regards to a remote employee if the employment activities are of an auxiliary nature, performed occasionally from home, or the employer does not require the employee to perform their duties from home and an alternative office is available.[175] The EAS draws a distinction for executive employees, where the employer might be seen to have control over a home office due to their level of employment and control over business operations.[176] Thereby, a mere lack of a request for an executive to work from home will not have an impact on whether the home office qualifies as a PE.[177]

Based on my review of the Ruling, the Agreement, and the EAS, it is clear that these sources emphasize two pivotal factors in determining whether a home office constitutes a PE: the regular and continuous use of the home office for business purposes and the degree of control exercised by the employer over that workspace. For example, in the Ruling, the employment contract explicitly designated the Employee's home as the primary workplace, with no alternative space provided, which was crucial in determining the home office was at the Employer's disposal. This contractual arrangement underscored the Employer's effective control over the home office, leading to the conclusion that it was 'at the disposal' of the employer. Additionally, the Employee's significant contributions to the employer's commercial operations in Denmark established that the activities performed at the home office were integral to the business and exceeded the threshold of being merely preparatory or auxiliary. Similarly, the Agreement highlights that structured, mandatory homework, particularly in situations where no alternative workspace is provided, can lead to PE recognition. The EAS further refines this analysis by introducing a distinction between executive and non-executive employees. It asserts that executive employees are more likely to

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[173] EAS 3445; D Germany; 0500 permanent establishment, available at *https://findok.bmf.gv.at/findok/volltext?execution=e100000s1&dokumentId=48ec5c6c-489d-443f-b84a-b6f49f1a207d* accessed on 1 June 2024. An unofficial translation can be obtained from this site.
[174] Ibid.
[175] Ibid.
[176] Ibid.
[177] Ibid.

trigger PE status, given their significant roles in business operations, even in the absence of explicit employer-imposed homeworking requirements.

As SA positions itself as a hub for digital nomads, the issue of home offices constituting a PE for foreign enterprises will likely arise more frequently. International guidelines, such as those from the Ruling, the Agreement, and the EAS, provide valuable benchmarks for South African authorities to consider. These guidelines indicate that home offices may constitute PEs if employees perform substantial business activities benefitting the enterprise, and if the home office is explicitly designated as the primary workplace with no alternative provided. The '50% rule', as outlined in the Agreement, offers a useful metric for assessing whether homeworking is incidental or regular. While incidental or voluntary remote work generally does not lead to PE recognition, structured and mandatory homeworking, where the employer exercises effective control over the home office, is likely to meet the criteria for PE status.

3.2. Remote Work and a Service Permanent Establishment

The introduction of the digital nomad visa, raises the question of whether remote workers present in SA for extended periods of time, can establish a taxable presence in the form of a service PE? In *ITC 1878*,[178] the court examined whether a PE was established in SA by a USA company through the provision of services by their employees.[179] The court had to determine how the DTA should be construed and whether the USA Company was required to have complied with both Article 5(1) and Article 5(2)(k) of the DTA.[180] The court ruled in favour of the South African Revenue Service, holding Article 5(2)(k) was an integral part of Article 5(1).[181] Therefore, meeting the 183-day threshold was sufficient to establish a PE without requiring further proof of a fixed place of business under Article 5(1). The court emphasized that the phrase 'includes especially' in Article 5(2) indicates the factors listed are inherently part of the PE definition in Article 5(1).[182] However, the court nonetheless decided the taxpayers had a fixed base in the utilizing of the boardroom of their client.[183]

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[178] *ITC 1878* (2015) 77 SATC 349.
[179] Ibid para 6.
[180] Ibid paras 18-44.
[181] Ibid para 40.
[182] Ibid paras 30–39.
[183] Ibid.

According to J Hattingh, the court's decision to establish a PE based on the temporary use of a client's boardroom raises questions about the continued relevance of the fixed place of business concept.[184] Traditionally, a PE requires a business to maintain a fixed physical location through which its operations are conducted.[185] There is widespread consensus that this concept is outdated, particularly in the context of modern service industries and digital economies, as noted by the OECD '*the spread of the digital economy also poses challenges for international taxation'*.[186] In today's business environment, many enterprises can operate without needing a permanent office or physical infrastructure, and yet they can still have a significant economic presence in a country. Therefore, the reliance on a physical location can be seen as overly rigid and misaligned with the realities of cross-border service provision. The UNMTC, allows for a service PE to be created based on economic presence rather than physical infrastructure.[187] Upon examining the relevant provision, it is evident that the UNMTC permits the creation of a Service PE based on economic presence rather than physical infrastructure. This approach prioritizes economic activity as the key determinant for taxability over traditional physical presence requirements.

The court's decision in *ITC 1878* can perhaps be seen as a convoluted attempt to align with the principle of economic presence, recognizing the US Company's substantial economic activities in SA as the employees of the companies were in the country for extended periods, and their work contributed meaningfully to local economic activity. The key takeaway is that, where a treaty includes a service PE clause, the extended presence of employees providing services in South Africa may be sufficient to establish a PE, even in the absence of traditional fixed premises.

As noted, the PE concept functions as a nexus for source taxation, determining when South Africa may tax business profits of a non-resident enterprise. I submit that South Africa's reliance on the OECD MTC as the starting point for most of its DTAs creates challenges in taxing business income generated by remote workers providing services in South Africa on behalf of a non-resident enterprise, where traditional indicators of a PE (such as a fixed office)

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[184] J Hattingh 'AB LLC and another v Commissioner of the South African Revenue Services' *International Tax Law Reports* 17 (2015) 911 at 915.
[185] Article 5(1) op cit note 15.
[186] OECD, '*Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report'* (2015), available at *https://doi.org/10.1787/9789264241046-en*, accessed on 1 August 2024.
[187] Article 5(3)(b) op cit note 15.

are absent. The determination ultimately depends on the specific wording of the relevant DTA. If it contains a service PE clause (as in Article 5(3)(b) of the UN MTC), the presence of employees rendering services in South Africa for a sufficient period could establish a PE. If no such clause exists, South Africa may struggle to assert taxing rights, and the interpretation of such a clause by a SA court remains unresolved, as demonstrated by the *ITC 1878.* While SA has adopted the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting,[188] their approach remains relatively 'cautious' as specific reservations have been made by SA in respect of Article 10 (anti-abuse rules for PE situated in third jurisdictions), 12 (artificial avoidance of PE status through commissionaire arrangements and similar strategies) and 14 (splitting up of contracts).[189]

The OECD MTC's, and inherently SA's failure to explicitly recognize a service PE leaves it potentially vulnerable enabling tax avoidance, by being disconnected from modern business realities, particularly in service-driven sectors where value creation is increasingly decoupled from physical infrastructure. The provision of services is increasingly decoupled from physical presence. For this reason, I recommend that SA should adopt UN MTC-style provisions that recognise substantial economic activity as a source-based nexus and update its domestic law to reflect modern business realities.

3.3. Remote Work and Agency Permanent Establishment

In relation to an agency PE, a dependent agent, acting on behalf of an enterprise, triggers a PE if they habitually conclude contracts which bind the enterprise in a specific jurisdiction. Temporary arrangements (such as those imposed by travel restrictions during COVID-19), generally do not establish a PE, as they lack the element of business-driven continuity and permanency. If an employee working remotely from their home in SA regularly concludes contracts for the enterprise, this can establish a PE.

[188] Multilateral Convention to Implement Tax treaty Related Measures to prevent Base Erison and Profit Shifting, in GN R2789 *GG* 47559 of 25 November 2022.
[189] Ibid.

4. RECOMMENDATIONS

To establish a PE, certain 'tests' must be satisfied. The lack of a fixed place of business in a traditional sense when it comes to remote working, presents an obstacle to SA's revenue authorities in applying the PE threshold, due to the lack of clear guidelines under existing PE rules, and varying interpretations. Currently, there is no commonly accepted solution establishing a consensus in tax treaties regarding remote work and its impact on taxation. A minimum threshold remains essential to ensure source-based taxation on income derived by a resident state in relation to a remote worker's activities in a source state.

As remote work becomes more prevalent, it raises the question of whether the concept of PE in SA should evolve. Instead of merely serving as a threshold for allocating taxing rights, the PE concept could potentially be developed into an anti-avoidance tool, helping to protect source-based taxation by addressing challenges posed by remote work arrangements and preventing tax avoidance strategies that exploit the blurred lines between physical presence. [190]

4.1. Recommendation 1: Define a Domestic Permanent Establishment Framework

SA domestic law defines a POEM in its domestic tax law and utilized it as a determinant of tax residency for companies,[191] and SARS has released extensive interpretation notes to guide its application.[192] By contrast, SA does not provide an equally detailed definition or outline for the concept of PE within its domestic law, nor any of their own interpretive criteria, instead relying on the definition outlined in Article 5 of the OECD MTC, and the explanations provided in the OECD Commentary.

SA should update its domestic framework with regards to providing a domestic definition of a PE in section 1 of the ITA. SA's domestic definition of PE must include clear guidelines as to when a PE is established with minimum thresholds, scenarios such as remote work, however,

[190] Olivier and Honiball op cit note 2 at 338.
[191] Section 1 of the ITA.
[192] SARS, Interpretation Note 6, Issue 3, titled: '*Resident: Place of Effective Management (Companies)'* 30 June 2023. SARS amended its predecessor, Issue 2, and in my view, is aligned with local and international jurisprudence, as well as the principles established by the OECD Commentary. It is trite that interpretation notes are not law and SARS are not bound by this, please see *Marshall and Others v Commission for the South Africa Revenue Service* 2019 (6) SA 246 (CC) para 10.

with the specific 'this is subject to the application of a DTA'. Thereby, in cases where there is uncertainty or dispute over the application and interpretation of PE rules between SA and another country, the Mutual Agreement Procedure ('MAP') provided under the DTAs,[193] can be utilized as a mechanism to resolve the relevant dispute.[194]

SA must ensure businesses providing significant services in the country are subject to tax, even without a physical office. In updating the domestic definition, SA can adopt a Service PE concept, similar to the UNMTC, which allows for the creation of a PE based on the provision of services in a jurisdiction for more than 183 days in a 12-month period, regardless of whether there is a fixed place of business. SA must provide explicit time periods in terms of physical presence, and when a non-resident company will be deemed to have a fixed place of business, a home office, for example, 'at their disposal'.

For example, SA can include a service PE is established when:

> 'an enterprise, through its employees or other personnel, provides services within the territory of the source country for a period or periods exceeding 183 days within any 12-month period. This service PE is constituted regardless of whether a fixed place of business exists in the source country. However, this definition is subject to the terms and provisions of the applicable DTA'.

In addition to clarifying the concept of a PE, South Africa should also strengthen its domestic source rules. At present, section 9 of the ITA provides general guidance on when income is regarded as having a South African source, but it is not sufficiently tailored to address modern business models where services are provided remotely, or value is generated digitally. Clearer domestic rules would reduce reliance on broad judicial interpretation and provide certainty to

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[193] For an example on the interpretation of POEM under the DTA, please see 'Memorandum of Understanding Between the Mauritius Revenue Authority and the South African Revenue Service concerning the Application of the Provision of Article 4(3) of the Agreement Between The Government of the Republic of Mauritius and the Government of the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income Signed on 17 May 2013 in Maputo' available at *https://www.treasury.gov.za/publications/other/Mauritius/MRA-SARS%20CA%20MOU%20on%20Article%204(3).pdf*, accessed on 1 August 2024.

[194] SARS 'Mutual Agreement Procedure (MAP) available *at https://www.sars.gov.za/legal-counsel/international-treaties-agreements/double-taxation-agreements-protocols/mutual-agreement-procedure-map/#:~:text=MAP%20is%20a%20procedure%20that,to%20resolve%20international%20tax%20disputes*, accessed on 1 August 2024.

both taxpayers and SARS. For example, legislation could specify that income from services rendered to South African clients is deemed to have a source in South Africa where the economic activity is effectively carried out in, or directed at, South Africa, even if the provider does not maintain physical premises.

4.2. Recommendation 2: Introduce an Economic Nexus Test

With the rise of digital nomads and remote working, the traditional PE concept based on physical presence may no longer capture significant business activities generating income in South Africa. The OECD work under Pillar One has already recognised that in a digitalised economy, businesses can participate actively and in a sustained way in the economic life of a jurisdiction with or without local physical presence.[195] SA should introduce an economic nexus test, focusing on the substantial economic activities carried out in SA rather than the existence of a 'fixed place of business'. [196] This would ensure companies creating value within SA are subject to tax, even if they do not maintain a physical office, or infrastructure in the country.

The economic nexus test is a principle used to determine whether a business has sufficient economic presence in a jurisdiction to warrant taxation, even in the absence of a physical presence. This test focuses on the substantial economic activities and value creation occurring within the taxing jurisdiction, rather than relying solely on the existence of a physical office, factory, or other fixed place of business.[197] The economic nexus approach would modernize SA's tax framework ensuring businesses benefiting from the SA economy, contribute their fair share of taxes.

4.3. Recommendation 3: Strengthen Anti-Fragmentation Rules

SA should introduce anti-fragmentation rules, preventing businesses from dividing their activities to avoid creating a PE. Remote workers can 'split' their time spent in SA to avoid the potential triggering of any tax obligations in terms of *de minimus* thresholds established, thereby, SA must introduce splitting up contract rules to avoid a remote worker from

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[195] OECD, OECD/G20 Base Erosion and Profit Shifting Project 'Tax Challenges Arising From Digitalisation – Report on Pillar One BluePrint available at *https://doi.org/10.1787/beba0634-en,* accessed on 15 August 2025.
[196] Mzwandile Ngidi op cit note 10 at 513-529 and 533-535.
[197] Ibid.

structuring their time frames present in SA. This will prevent enterprises from exploiting the remote work model to conduct significant business activities without paying taxes in the source state.

5. CONCLUSION

The concept of PE has been thoroughly explored in this research report, highlighting its importance as a threshold for source taxation, where profits generated in the source state are attributable to the presence of a PE.

Article 5 of the OECD MTC, and the OECD Commentary serves as a guide for identifying PE, listing various examples and criteria, including exemptions. SA's definition of a PE mirrors the OECD MTC. The chapters critically analysed how these principles apply to specific business activities, to determine if a PE exists. Not all activities of a non-resident enterprise create a PE, particularly if they are temporary or preparatory in nature, as exempted under Article 5(4) of the OECD MTC. For instance, in the case of an agency PE, it is necessary to establish whether the agent is dependent or independent, as per Article 5(5) and (6). It was noted, with reference to foreign case law, the activities of a remote worker in SA are at risk of creating a PE for a non-resident entity.

The PE criterion remains the sole determinant for allocating tax rights over business profits.[198] An analysis of this threshold underscores significant implications within the existing framework, revealing a lack of clarity that has contributed to heightened uncertainty and challenges in effective enforcement within a source state. The definitional ambiguity surrounding what constitutes a PE in modern, particularly in the context of evolving business models and remote work, have complicated the consistent and equitable application of taxation. As a result, the current PE definition may not be adequately equipped to address the challenges posed by modern working models, leading to enforcement issues in SA.

By including a domestic of PE, and incorporating a Service PE, a minimum threshold for when a remote worker will trigger a PE in SA, an economic nexus test, and strengthening anti-avoidance provisions, SA can adapt to modern business realities, close tax loopholes, and

[198] Masuchand op cit not 121 at 20.

ensure both traditional businesses and digital/remote service providers are appropriately taxed for economic activities carried out within the country. Ensuring SA remains competitive in the global economy.

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