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Permanent Establishments: A Conceptual Analysis and Challenges Ahead

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In this article, the authors examine the evolution of the permanent establishment concept beginning with its “inception”, as reflected in article 5 of the OECD Model and its Commentaries. The article goes on to look at the challenges arising from the digital economy due to the complexity in determining which territory a business activity is connected to. Remote working has added an additional layer to these challenges. The authors look at both OECD and EU initiatives that have been introduced to clarify the PE notion in this evolving area of international taxation and conclude that a common PE definition can be achieved only once proposed directives have been transposed into domestic law, without exceptions.

1. Introduction

The notion of a permanent establishment (PE) is a crucial element of the international tax system, as it regulates the allocation of (i) taxing rights between source and residence countries and (ii) fair remuneration and proper participation in the taxation process between the head office and host countries. This article examines the evolution of the PE concept starting from its “inception”, as reflected in the OECD Model and Commentaries, and then turning to the new challenges arising from the digital economy, which makes it complicated to determine which territory a business activity is connected to due to the fact that workers frequently move around the globe as remote workers or teleworkers.

There have also been a number of EU initiatives that have impacted the PE notion in Europe. For example, the EU Minimum Taxation Directive (2022/2523)^[1] imposes a global minimum tax on multinational enterprises (MNEs). For this purpose, it establishes a specific PE definition.

Further, there is the Proposed EU Transfer Pricing Directive,^[2] which suggests that the PE definition should follow the development of profit allocation rules to provide tax certainty and mitigate the risk of double taxation.

In examining this issue, section 2. of this article breaks down article 5 of the OECD Model (2017).^[3] Section 3. examines recent updates to the PE concept as a result of Action 7 of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project. Section 4. discusses the rethinking of the PE definition in the context of the digital economy, as well as the increase in hybrid and remote working. Section 5. comments on shifts in the PE concept resulting from EU legislative initiatives, such as implementation of the EU Minimum Taxation Directive (2022/2523) and the Proposed Transfer Pricing Directive, followed by the authors' conclusions in section 6.

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 1. Council Directive (EU) 2022/2523 of 15 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union, OJ L 328 (22 Dec. 2022), Primary Sources IBFD.
 2. European Commission, Proposal for a Council Directive on Transfer Pricing, COM(2023) 529 (12 Sept. 2023), available at https://taxation-customs.ec.europa.eu/system/files/2023-09/COM_2023_529_1_EN_ACT_part1_v7.pdf (accessed 31 Jan. 2024) [hereinafter Proposed TP Directive].
 3. OECD Model Tax Convention on Income and on Capital (21 Nov. 2017), Treaties & Models IBFD.