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United Nations Model Tax Convention Article 5: The Predatory Ploy – A Neo-Marxist Mapping of the Permanent Establishment

Muhammad Ashfaq Ahmed*

ABSTRACT: *The cornerstone of the extant international taxes system as laid out by the United Nations Model Tax Convention (UN MTC) is the Permanent Establishment (PE). The study seminally juxtaposes the PE principle in between the competing ideological pulls of capitalism and communism, and explores into the role it played towards the survival of the former disproving Marx's deathly prognosis of an early demise of the capitalist mode of production. The argument – both spatially and temporally – is anchored in the PE's evolution in the mid-19th century Prussia. The Prussian politico-economic milieu that helped conceive and contrive the PE as a mechanism of ensuring taxation in the source state, is employed as a backdrop to analyze PE's development through subsequent epochs of history into what it has grown into presently – a tool of predation by the multinational corporation (MNC) on the developing country fiscal rights. The PE's design manipulability is unraveled on a number of counts in a developed-developing country binary to argue that the PE-propped plunder carried out over the past century was sustained through a brute semantic occupation and elimination of alternatives, which was further reinforced by Neo-Marxists' utter failure to adequately dissect and respond to the capitalist ploys. It is contended that recent oblique shift from the 'physical presence' to 'economic presence' as the basis for sharing taxing rights on business incomes between states, may be due to MNC excesses rather than digitalization of global economy as generally believed. It is further argued that a quarter to two centuries down the road, as the Organization for Economic Cooperation and Development (OECD) frames rules to ensure taxation in the source state, it actually re-enacts Prussia; the wheel of time has run full circle.*

The ideas of the ruling class are in every epoch the ruling ideas, i.e., the class which is the ruling material force of society, is at the same time its ruling intellectual force.
Marx

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* Muhammad Ashfaq Ahmed is a Pakistan IRS officer and is currently posted as Member (Inland Revenue), Federal Board of Revenue, Islamabad; he holds PhD in Political Economy.

1. INTRODUCTION

The axle of the *United Nations Model Tax Convention* (UN MTC) is the permanent establishment (PE). The UN MTC Article 5 defines the PE as 'a fixed place of business through which the business of an enterprise is wholly or partly carried on'.[1] In turn, the UN MTC Article 7 that has been reckoned 'a key provision' not only because it 'allocates taxing rights' between the state of residence of the enterprise and the state of source of the income,[2] but also because it inextricably connects the taxation of business income to the PE by stipulating that 'profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein'.[3] In essence, the PE is nothing more than a legal fiction contrived to raise taxability by a country on incomes earned by persons domiciled or based in another country. It is posited that the vital principle underlying the innocuous-looking expression of the PE is the physical presence test implying actual physical presence to give rise to chargeability in the source state. It follows that physical presence test shaping into a fixed place to constitute PE as a condition precedent for taxability to arise in source state had 'a darker purpose', and that a lot more needs to be read into than has been – historically.

The study traces genesis of the PE in time dating back to 1840s, when it was first conceived, contrived, and legislated via the Prussian Industrial Code, 1845, and by plugging it into another epoch-making event that occurred on the European soil a couple of years later – the launching of the Communist Manifesto – expands its semantic context and frontiers. The Communist Manifesto launched in London in 1848 ushered in communism as a formidable ideological challenge to capitalism, and Karl Marx as the most potent voice on human condition. It is premised that both occurrences, at some level, were curiously connected not as much in that moment as much in their lateral progression with both ferociously haggling, outmaneuvering, and checkmating each other. It is averred that in order for history to be better understood, PE placed in the midst of capitalism and communism may be a reasonable alternative proposition.

The study sets itself the ambitious agenda of reinvestigating into the all-important legal instrument of PE from the prism of three key premises. Firstly, that PE through its evolutionary process, was contrived into a tool of predation by the capitalist state on the developing states' fiscal rights. The premise is explored into by undertaking a critical appraisal of the evolution of the concept of PE over the past hundred years. The structure, role and conduct of the multinational corporation (MNC) is also inducted into the analysis as a predation optimization tool on the PE. The predatory overtures of developed countries on legitimate taxing rights of developing countries are dissected, inter alia, on account of PE's design exploitability, its direct nexus with exportation of surplus investible capital, disengagement from the purchase function,

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[1] UN, *United Nations Model Double Taxation Convention between Developed and Developing Countries 2017* (New York: Department of Economic & Social Affairs, 2017), art. 5(1).

[2] UN, *United Nations Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries 2019* (New York: Department of Economic & Social Affairs, 2019), at 81.

[3] Art. 7(1) of *United Nations Model Double Taxation Convention between Developed and Developing Countries 2017*, *supra* note 1.

disassociation from the exportation of finished goods, contributory role to treaty shopping, inherent manipulability of the construction and service Pes, and elusiveness of ‘force of attraction’ rule. The argument being built is that the capitalist state leveraging their economic might into negotiating power first successfully connected the taxation of international business income to the PE, and then leveraged it to dilute the very principle of PE and its actual application in reality.

Secondly, that an alternative and probably more relevant perspective to analyze the PE with all its constructive or destructive potential may be the neo-Marxist approach. Marxists hold that capitalists constantly accumulate capital, and in the process, impoverish workers and create social conditions fit for a revolution that would eventually overturn the very institution of capitalism. They also believe that private proprietorship results in dependence of non-owning class on the owning class initially within the capitalist state, and then as aggregate demand dwindles and raw material base depletes, the process gets transported to developing countries – internationalization of capitalism. Neo-Marxism, in turn, transcends Marx’s original theory and connects it with other analytical streams like psychoanalysis, structuralism, existentialism, and instrumentalism, and lends focus to the exploitation of the state towards realization of the capitalistic goals both nationally and internationally. It is predominantly in its latter context that Neo-Marxism has been employed as the analytical framework to dissect the PE’s real intent and implications.

Thirdly, that PE, at some level, has been instrumental in disproving Marx’s prognosis of capitalism’s early demise. Marx had, after all, predicted that capitalism fraught with inherent contradictions and malaises would soon run into crisis and meet its doom creating space for communism to fill in the ideological vacuum. He also went on to unambiguously identify the very sources of conflict in capitalism. Once Marx had clearly pinpointed the very mechanics of the impending crisis and the way those worked, onus lay on capitalists to make suitable outmaneuvers. Conversely, responsibility also rested on Marxists to dissect, deconstruct, and interpret the capitalist ploys, and subterfuges for the proletariat and their new variants to enable them to protect their rights in this ever-anarchic world of perpetual contestation for economic, cultural, and political domination. It is stipulated that while capitalists discharged their onus well enough and staved off the crisis and kept capitalism afloat, the later Marxists failed in their avowed mission. The capitalist state’s adoption of welfarist policies, and use of socialistic manifestos by their political parties, cooption of neo-capitalists into the system, quantum improvement in wages and working conditions of the blue-collar class, and diversification of industrial base, could be taken as existential capitalist stratagems.

However, it is argued that capitalists’ most effective decoy was the PE, which could not be identified by Marxists and analyzed in its true essentials, intent, implications, and operations to the ultimate chagrin of marginalized billions living in developing countries. A great majority of double taxation conventions (DTCs) that have been signed over the past century by developing countries purportedly modeled on the UN MTC conveniently espoused the PE principle to abdicate taxing rights in all non-PE scenarios. This gives rise to a paradox, which ‘emanates from the fact that the UN MTC is not only meant to serve as a template for

negotiations between developed and developing countries, but also to champion and protect fiscal rights of developing countries vis-à-vis developed countries'.[4] This is in sharp contrast to the OECD MTC, which admittedly looks to promote fiscal interests of the developed countries. The paradox between UN MTC's stated position of a protector of developing countries' rights, and a meek capitulation and abdication of the source state's taxing right on business income by linking it to the presence or absence of PE, may potentially have resulted in inestimable fiscal fallouts for the denizens of the developing world.

This way multinational corporations (MNCs) domiciled in developed countries were not only allowed to generate large sums of revenues by doing business in the developing countries, but were also permitted to repatriate them tax-free thereby hurting their exchequers and foreign exchange reserves, simultaneously. The UN apparently was framed into accepting a principle of taxing rights on behalf of the developing nation with unthinkable fiscal implications, which was patently in favor of the developed one. It follows that UN MTC, in fact, committed a blunder by connecting source taxation rights on business income to the physical presence test on behalf of developing nations as it cost them substantially not only on account of tax revenue foregone which essentially was being generated by their own economic agents and on their own soil, but on a number of other counts, too.

The situation, however, appears to have reversed towards the beginning of the present century – not due to any realization of the past mistakes by the UN, or its MTC, but due to the internal mechanics of capitalism and the way those worked, as manifested in the OECD's mild shift towards accepting significant economic presence test as an alternative to physical presence test under the profit shifting and base erosion (BEPS) project. It is posited that while the capitalist state went overboard to propel MNC to predate on developing countries by leveraging on the PE, over time, MNC grew into a monster to take on capitalist state itself. Thus, softening of OECD's position from physical presence to economic presence does not come out of any altruistic impulse, but a compulsive move to harness back the MNC, retrieve the funds that MNC stole of the capitalist state and hid in tax havens. The aim is to seminally trace down the ideological dynamics at work in the conception, evolution, and operations of PE, and the way it was leveraged by the capitalist state as a tool to predate on the developing state.

The study is divided into seven sections. After exposition of the topic in section 1, section 2 brings in Marx and the Marxist prognosis of capitalism and its predicted doom. Section 3 deals with the very genesis of the PE in the Prussian context starting 1840s till WWI. Section 4 covers the PE's evolution during the all-important inter-war period. Section 5 takes account of the PE in the post-WWII scenario and the currently prevailing international consensus on this score. Section 6 gleans on the PE's adverse implications for the source developing states, and its oblique BEPSization. The study concludes in section 7 with a brief summation.

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[4] Muhammad Ashfaq Ahmed, 'U.N M.T.C Article 8: Was the Source Rule Surrender a Blunder? The Case Study of Pakistan', *Intertax*, 2020, 48(1): 1-26.

2. MARX, PE AND CAPITALISM

Although, the term *capitalism* entered lexicon of political economy and philosophy only as recently as the middle of 19th century, the phenomenon which it sought to capture had identifiably existed, at least, since the renaissance time.[5] Capitalism implies an economic order that is based on private proprietorship of means of production, is mainly driven by the motive of profit, which, in turn, is determined by the market forces of demand and supply.[6] Key features of capitalism are private property, capital accumulation, wage labor, voluntary exchange, a money or currency to effect voluntary exchange, and competitive markets.[7] At an advanced stage, capitalism exhibits land and capital owned by private individuals or groups of private individuals organized into firms, which give traction to its impact, vitality and output.[8] In market economy, key decisions vis-à-vis resource allocation are optimally made as the prices of goods and services are determined through competition in the market.[9] The capitalism is criticized, inter alia, for concentrating exploitative powers in the hands of minority at the expense of majority. On the flip-side, capitalism's apologists contend that it breeds opportunity, generates wealth, and enhances welfare through innovation and competition, provides jobs to most productive people, promotes pluralism, decentralizes power, creates strong economic growth, increases productivity and enhances prosperity, which multiplies collective well-being of the society. This section argues that capitalism, PE, and Marxism are inextricably linked.

2.1. Marx on Taxation

Like already noted, the 1840s saw two tremendously potent events occur on the European soil: first, the inception of PE through promulgation of the Prussian Industrial Code, 1845; and second, the launching of the Communist Manifesto, 1848. The Communist Manifesto, put forth by Karl Marx and Friedrich Engels, on February 21, 1848, in many respects, is equated with the creation point of communism. The Manifesto prescribed and set for itself high utopian goals under communistic system of government that it ultimately looked to realize. By way of an aside, one of the important objectives of the Manifesto was to restore equality in society by fulfilling all basic needs of its constituent members through imposition of progressive taxation thereby enabling governments to appropriate a substantial portion of economic surplus generated through capitalist mode of production. The long term goal for the state under communism, however, was to be able to directly expropriate the surplus and distribute it amongst citizens according to their needs. It was against this thought process that Marx proposed 'a heavy progressive or graduated income tax as a means of overcoming the capitalist order',[10] and a medium-term corrective action. The fact remains that Marx's ideas on taxation

[5] Fernand Braudel, *The Wheels of Commerce: Civilization and Capitalism 15th–18th Century* (New York: Harper and Row, 1982).
[6] Zimbalist Andrew and Howard J. Sherman, *Comparing Economic Systems: A Political-Economic Approach* (Hartcourt College Pub, 1988), pp. 6-7.
[7] Louis Hyman and Edward E. Baptist, *American Capitalism* (New York: Simon & Schuster, 2014).
[8] Mariana V. Rosser and J. Barkley, *Comparative Economics in a Transforming World Economy* (Boston: MIT Press, 2003), at 7.
[9] Paul R Gregory and Robert C Stuart, *The Global Economy and Its Economic Systems* (Mason, Ohio: South-Western Cengage Learning, 2014), at 41.
[10] Richard A. Musgrave, 'Theories of Fiscal Crises: An Essay in Fiscal Sociology', in H. Aaron and M. Boskin (eds.), *The Economics of Taxation* (Washington DC: Brookings Institution, 2011), at 361.

are scattered in his writings and it is difficult to draw any orderly and meaningful picture on this count.

2.2. Marx's Prognosis of Capitalism

Marx had predicted that capitalist mode of production being inherently beset with malaises and internal conflicts would soon go into crisis and meet its doom. Marx did not stop there; he went on to unambiguously identify the very sources of such internal conflicts.[11] In fact, there is an interrelated set of five sources of troubles that can be gleaned from Marx's works which in his view, would eventually cause first a crisis in the capitalist system, and then help replace it with communism. First, Marx took money as the prime source of inevitable crisis in capitalism. He espoused traditional notion of money being a commodity the value and role of which was determined by its cost of production and other intrinsic features like divisibility, transportability, perishability and acceptability. Second, Marx like Adam Smith and David Ricardo believed capitalist mode of production suffered from a primeval tendency of declining rate of profit and linked it to the very demise of the capitalist system. Third, Marx's initial model of capitalist market is fully competitive, but since competitiveness is to be sustained by relentless innovation, it could turn too expensive and capital-intensive pushing entry cost too high for new entrants. Fourth, Marx was of the view that capitalist system was pre-programmed to overproduce in that when all workers, by putting all of their wages together, would not be able to buy all what they had produced, it would lead to a situation where part of the production would stay unsold. Fifth, Marx reckoned workers' disillusionment, alienation, and resultant regimentation within capitalism a foregone conclusion. This, in turn, would result in fewer and fewer benefits for workers, at which stage, strangled to deprivation in the midst of all the capitalist abundance, workers' frustration would reach its crescendo and they would start to militarize themselves nurturing notions to take on the system.[12] Thus, Marx believed that the foregoing five factors would soon lead capitalist system to crisis, which would, inter alia, be signified by a limited tally of monopolies operating in each sector of the economy, productive process going sluggish across the board, victims of monopoly capitalism adding to the unemployed workforce with all their frustrations, which could evolve into a revolutionary movement whereby the proletariat will take over the state, the means of production will be nationalized and a socialist order will be brought into being but only as a stepping-stone for an eventual full-fledged realization of communist system, instead.

2.3. Internationalization of Capitalism

Marx thought that interplay of the five identified sources of inevitable crisis would first appear in European capitalist states, and then would spill over into developing countries of Asia, Africa, and South America by way of internationalization of capitalism or imperialism. The inevitable capitalist crisis, he believed, could be staved off for a time through imperialistic internationalization of capitalism. To Marx, weakening of aggregate demand in the economy

[11] F. Boldizzoni, *Foretelling the End of Capitalism: Intellectual Misadventures since Karl Marx* (Harvard University Press, 2020).
[12] *Ibid*.

caused by failure of working class to buy all what it had produced, would inescapably lead to imperialism – monopolization of new markets. But since all capitalist states would be in scramble for new markets where they could buy inexpensive raw materials and sell their finished products, they would soon come into conflict with one another resultantly imperializing the entire world. Thus, essentially capitalism had no escape from the impending crisis. Barone validates this premise by stating that one of the fundamental tenets of Marx's theory was that 'capitalism has an inherent tendency to internationalize itself and thereby to expand the reproduction of the means of production and the relations of production on a world scale', and that eventually 'capitalism breaks down all pre-capitalist modes of production and capital is compelled to accumulate as rapidly as possible the world over'.[13] Lenin had amplified Marxist theory and argued that capitalism inevitably led to monopoly capitalism, and the export of capitalism, which he also called 'imperialism' to find new markets and resources, representing the last and highest stage of capitalism.[14] Thus, while Marxists could predict with certitude that capitalism would overflow its existing frontiers into underdeveloped regions and imperialize them, they failed to address the attendant issue of taxation, which is an apparent missing component in the Marxist theory.

2.4. Marxists' Failure

Once Marx had identified the very mechanics of the impending crisis and the way those worked, and emphatically predicted that capitalism would first go into imperialist mode, and then eventually fall apart, the onus lay on capitalists to outmaneuver Marxian predictions. Simultaneously, responsibility also rested on Neo-Marxists – Marx's intellectual progeny – to detect, deconstruct, and neutralize capitalist gambits for the proletariat and their modern-day analogs through 20th and 21st centuries so as to enable them to protect their economic and other interests in this anarchic world of perpetual contestation for economic, cultural, and political domination. It is averred that while capitalists discharged their onus well enough to stave off the crisis and keep the capitalist mode of production afloat, Neo-Marxists failed in their mission. The capitalist state's welfare-oriented overtures, excessive and pronounced usage of the socialist jargon by capitalist states, cooption of neo-capitalists into the system, quantum improvement in wages and working conditions, rise of service industries, and diversification of the industrial base, could be taken as capitalism's existential stratagems. Miliband argues that by selectively adopting welfare character of the socialist state, capitalism was able to ward off resentment and discontent that might have brewed up within the working and low-lying classes, and therefore 'welfare state is capitalism's best friend'.[15]

2.5. Capitalist Outmaneuvers

It is, however, contended that capitalists' most effective and equally innocuous-looking outmaneuver was the PE, which could never be spotted by Neo-Marxists and analyzed in its true intent, implications, and operations to the ultimate disadvantage of developing countries.

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[13] C.A. Barone, *Marxist Thought on Imperialism: Survey and Critique* (Taylor & Francis, 2016), at 180.
[14] Vladimir Ilyich Lenin, *Imperialism: The Highest Stage of Capitalism* (Petrograd, 1917).
[15] Ralph Miliband, *The State in Capitalist Society* (London: Winfield and Nelson, 1969).

By exploiting PE, the capitalist state harvested inestimable fiscal fruits from the developing world over the past hundred years. Once the PE had been effectively paved, the capitalist state needed to exploit it; it contrived MNC to ply thereon, metaphorically speaking, as a truck.[16] This is how the super-survivalist capitalist combine – PE and MNC – stealthily trojanized international business and allied fiscal systems to legitimize transfer of bulk of economic surplus from the developing to the developed world.

3. PE – GENESIS OF THE PROMETHEUS[17]

The PE, non-technically speaking, is in fact, a legal fiction,[18] which is raised to create a fiscal charge by a country on the incomes earned inside its jurisdiction by a person that is politically domiciled or legally established in another country. Apparently, the concept is nothing more than a pedestrian technical taxation tool, yet in reality, it has had fiscal implications far more than generally associated with it for every single polity and economy, depending upon, how much it has ingressed into its tax system.

3.1. PE – Early Evolution

A broad consensus appears to have emerged amongst scholars that the concept of PE originally emerged in Prussia in mid-1840s.[19] The Prussian Industrial Code, 1845, which was fundamentally enacted to regulate commerce amongst constituent provinces of Prussian Empire ended up contriving the mechanism of PE that essentially meant that an entrepreneur wherever based could be taxed on its profits earned inside another Prussian state through only its PE implying an office, a storage facility or factory. At a little deeper level, it was an expression of festering economic disparities – perceived, real or feigned – amongst various German regions. Historically, the states falling in the east of the Prussian Empire developed at a perceptibly slower pace than those falling in its west. It has been remarked that ‘Compared with Hesse, Ducal Prussia (East Prussia) remained a domain state and contributed taxes to the territorial income sporadically’.[20] Thus, while east Prussian provinces were chiefly agrarian ruled by traditional Prussian landed nobility, the western ones abounded in industrial entrepreneurs, which were exporting finished products to the eastern provinces, but contributed negligibly to the local exchequers. The realization of this asymmetrical trade grew widespread at the same pace as its volume and skewed development across Prussian provinces.

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[16] See, for a detailed analysis of the interplay between MNC and capitalism, G. Jones and I. Jones, *Multinationals and Global Capitalism: From the Nineteenth to the Twenty First Century* (London: Oxford University Press, 2005); G. Barak, *Unchecked Corporate Power: Why the Crimes of Multinational Corporations Are Routinized Away and What We Can Do About It* (Taylor & Francis, 2017).

[17] In Greek mythology, Prometheus literally meaning ‘forethought’, is a Titan and a trickster, who defied the gods by stealing fire. Zeus, the King god, sentences the Prometheus to eternal torment for his transgressions.

[18] Henri Capitant has defined a legal fiction as ‘a legal technique leading to an assumption of a fact or a situation different from reality so as to deduct therefrom legal consequences’.

[19] M. Kobetsky, *International Taxation of Permanent Establishments: Principles and Policy* (New York: Cambridge University Press, 2011).

[20] B. Yun-Casalilla, P.K. O’Brien, and F.C. Comín, *The Rise of Fiscal States: A Global History, 1500-1914* (Cambridge University Press, 2012), at 151.

3.2. Zollverein

This feeling became widespread after the establishment of Zollverein (German Customs Union), which went into operation on January 31, 1834.[21] The Zollverein was the product of intra-Prussian trade structure that had traditionally been identified with extraordinary trade barriers as in 1790 there were about '1800 customs frontiers in Germany as a whole', and in 1816, Prussia alone had some sixty internal tariffs.[22] There are wide-going divergences amongst scholars as to the dynamics of the formation of Zollverein ranging from political, to nationalistic, to developmental to fiscal, as much to its outcomes. Breuilly argues that 'at the level of intention the main concerns were state and fiscal, not national and developmental, and some contemporaries with liberal, national and developmental concerns opposed Zollverein'.[23] Maisto posits that the development of PE principle in Europe was attributable to *impôts reels* – 'an untranslatable expression for a series of separate taxes imposed on different types of income on a source basis, such as a tax on land, and a tax on business profits'.[24] Thus, while individual Prussian provinces looked to promote their particularistic economic interests within the framework of Zollverein, economic disparities already extant started to galvanize as industrialized provinces in western Prussia would import raw materials free of charge and then flood back the less developed and agrarian eastern Prussia with finished goods. The Code promulgated partially to counteract Zollverein – to the less developed east Prussian states (to the extent of innovation of PE), was an effort to protect their fiscal interests; to the more developed west Prussian states, it was necessary groundwork for the irrepressible capitalism that was looking to explode across Germany (and, in fact, most of Europe) in the wake of relentless industrialization.

3.3. PE's Codification

In 1891, the PE was codified in Prussia. Under the codification, the PE included business undertakings, branch operations and places for purchasing.[25] When Prussia and Austro-Hungarian Empire signed the first ever truly international DTC to support cross-border trade on June 21, 1899, the PE formed its pivot. A couple of decades later, when the German Double Taxation Act, 1909, was legislated to overcome the problem of fiscal and/or economic double taxation within the German Federation, central tool deployed to achieve the objective was the PE. Therefore, the only way the conception and genesis of the PE could be interpreted in its spatial and temporal contexts was the diverse fiscal aspirations nurtured and fueled by economic disparities between the eastern and western Provinces then constituting the Prussian empire. The PE and all what it fiscally meant to the eastern Prussian provinces was the second best solution – the first best being unbridled source taxation rights. Now, if the eastern and western

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[21] The general customs union agreement covered the states of Prussia, the two Hesses, Bavaria, Wurttemberg, Saxony, and some small German states; new members joined between 1835-88.

[22] P.G. Cocks, *Political Integration and the Growth of Capitalism in Western Europe: A Study of Anglo-Scottish Unification, Nineteenth Century Germany and Post-World War II European Unification* (University of Wisconsin, 1976), at 300.

[23] J. Breuilly, *Austria, Prussia and the Making of Germany: 1806-1871* (Taylor & Francis, 2014).

[24] Guglielmo Maisto, *Residence of Companies under Tax Treaties and Ec Law* (Amsterdam: IBFD, 2009), at 159.

[25] Kobetsky 2011, *supra* note 19, at 111.

coordinates are replaced with southern and northern ones, respectively, the corresponding analytical premise can be internationalized and temporally extrapolated to the remainder of 19th, whole of 20th, and 1st two decades of 21st century.

4. PE – Inter-War Period

In the aftermath of WWI, on January 10, 1920, League of Nations (LN) was established as a result of Paris Peace Conference that brought an end to hostilities. The *Covenant of the League of Nations* was signed by 42 founding member countries.[26] Under the Covenant three main institutions of the League, that is, the Assembly, the Council, and the Permanent Secretariat, were established.[27] The League's purpose, as per its Covenant, was 'to promote international co-operation and to achieve international peace and security'.[28] Although, the Covenant primarily concerned itself with the prevention of war and conflict resolution yet it also provided for the 'equitable treatment for the commerce of all Members of the League'.[29]

The League's Council, as early as February 1918, passed a Resolution to 'convene an international conference to study the financial crisis and look for the means of remedying and mitigating the dangerous consequences arising from it'.[30] The ensuing International Financial Conference that convened at Brussels in late 1920, espoused unto itself, inter alia, international taxation, and professed to make progress on 'an international understanding, which, while ensuring the due payment by everyone of his full share of taxation, would be facilitating placing of investments abroad'.[31] However, as Cockfield believes 'when nations became concerned that international double taxation was inhibiting international trade and investment',[32] the task of overcoming international double taxation was also assigned to the League on an urgent basis. It is through the prism of the League's outputs that a visibly erratic, subdued, yet well-steered evolution of PE within larger and superior context of capitalism's ideological struggle for survival can be traced.

4.1. LN Report 1923

In pursuance to the Financial Conference, the Council created two Provisional Committees, namely, Economic Committee and Financial Committee with clearly demarcated work descriptions;[33] international taxation fell in the basket of the latter. The Financial Committee, in September, 1921, observed that 'there are grave objections,…to existing systems of taxation,

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[26] The *Covenant of the League of Nations* (signed on 28 June 1919, entered into force 10 January 1920) was included in the *Treaty of Versailles* (signed on 28 June 1919, entered into force 10 January 1920).
[27] Charles Howard Ellis, *The Origin, Structure and Working of the League of Nations* (New York: Houghton Mifflin, 1928), at 67.
[28] Martin Hill, *The Economic and Financial Organization of the League of Nations: A Survey of Twenty-Five Years' Experience* (Washington: Carnegie Endowment for International Peace, 1946).
[29] Art. 23(e) of the *Covenant of the League of Nations*.
[30] League of Nations, 'International Financial Conference Brussels, 1920', in League of Nations (ed.), *Proceedings of the Conference*, vol. 1 (Brussels: Pub. for the League of Nations, 1920), at 3.
[31] *Ibid.*, at 26.
[32] Arthur J. Cockfield, 'Reforming the Permanent Establishment Principle through a Quantitative Economic Presence Test', *Can. Bus. L. J.*, 2003, 38: 400-22.
[33] Yann Decorzant, 'Internationalism in the Economic and Financial Organisation of the League of Nations', in Daniel Laqua (ed.), *Internationalism Reconfigured: Transnational Ideas and Movements between the World Wars* (I.B.Tauris, 2011).

in so far as they compel citizens and corporations of one country to pay taxes in more than one country in respect of the same taxable subjects', and wherefore 'possibility of an international convention regulating the matter should be considered'.[34] Accordingly, the Financial Committee decided to engage four well-known experts later called the 'Four Economists',[35] for their professional input. The Economists submitted their Report on April 3, 1923,[36] the primary focus of which remained double taxation of public securities. This was a key concern within the temporal context and warranted adequate attention from the important angle of international capital mobility.[37] The Report after discussing general principles of taxation held that the doctrine of economic allegiance was by far the most apposite basis of taxation in an international setting. The elements of economic allegiance, as determined by the Economists with reference to various categories of income and wealth were origin, situs, enforceability, and domicile. In connection with the taxation of 'commercial establishments' the origin was reckoned to be the preponderant element.[38] The Report also took pains to determine principles of taxation at origin or domicile for various categories of income. It was opined that LN's Report 1923, broadly reflected the aspirations of and was 'the product of creditor nations'.[39]

4.2. LN Report 1925

Well over a year prior to the publication of LN Report 1923, Italy had 'proposed a conference of government officials to reach practical solutions on the more pressing double taxation issues'.[40] The proposal ostensibly emanated from a desire to appraise the issue at more practical level. Accordingly, Financial Committee went ahead with consulting three states that already had an experience of negotiating and finalizing double taxation treaties, and three more states[41] that were likely to be interested in the matter.[42] Jogaranjan holds that 'the impetus for the conference of government officials was in fact tax evasion and not double taxation as commonly thought', and that the 'countries represented at the conference were chosen due to their interest in tax evasion and not for political reasons, as previously assumed'.[43] Graetz and O'Hear argue that 'underlying politics was obvious', as 'while the LN Report 1923 was the product of creditor

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[34] Provisional Economic and Financial Committee, 'Report to the Council upon the Session held at Geneva, August-September 1921, Communicated to the Assembly in Accordance with the Council's Resolution of September 19th 1921' (A.95.1921.II), at 6. See, for further details, Sunita Jogaranjan, 'Stamp, Seligman and the Drafting of the 1923 Experts' Report on Double Taxation', *World Tax Journal*, 2013, 5(3): 368-92.
[35] The Four Economists were Prof. Bruins of Commercial University, Rotterdam, Prof. Senator Einaudi of Turin University, Prof. Seligman of Columbia Uniersity, and Sir Josiah Stamp of London University.
[36] G. W. J. Bruins (ed.), *Report on Double Taxation*, E.F.S.73.F.19 (Geneva: League of Nations - Economic & Financial Commission, 1923).
[37] See, for a detailed discussion, Jogaranjan 2013, *supra* note 34.
[38] G. W. J. Bruins (ed.) 1923, *supra* note 36.
[39] Michael Graetz and Michael O'Hear, 'The "Original Intent" of U.S. International Taxation', *Duke Law Journal*, 1997, 46(5): 1021-110.
[40] Minutes of the First Meeting of the Sixth Session of the Financial Committee of the Provisional Economic and Financial Committee held at 11am on 23 February 1922, in Geneva - League of Nations Archieves; Box R 333:E.F/FinanceVI/P.V.I: United Nations, Geneva - as cited by Sunita Jogaranjan, *Double Taxation and the League of Nations* (Cambridge University Press, 2018).
[41] The states, in first category, were the Great Britain, France, and Belgium, and in the second, the Netherlands, Italy, and Switzerland.
[42] Sunita Jogaranjan, 'Chapter 9. The Drafting of the 1925 League of Nations Resolutions on Tax Evasion', in Peter Harris and Dominic de Cogan (eds.), *Studies in the History of Tax Law*, vol. 7 (Hart Publishing, 2015).
[43] Jogaranjan 2018, *supra* note 40.

nations', LN Report 1925 was the output of the 'debtor nations'.[44] Wells and Lowell tend to adopt an identical line of argument on the matter.[45] The LN Report 1925 exhibits three broad influences, namely, the Economists' Report the practical considerations, and pre-existing treaty practices.[46] The Great Britain 'often turned to economic theory on the free flow of capital to promote residence-country taxation particularly in the case of impersonal taxes on interest income'.[47] On point of allocation of taxing rights, the Report follows LN Report 1923, by stating that 'when double taxation is involved, governments would be prepared to give up residence rather than origin as establishing the prime right'.[48] Although, PE principle was not overly flaunted, one could read a nuanced shift in favor of and towards the domicile-based taxation.

4.3. LN Report 1927

The seeds for yet another effort under League's framework had been sown in LN Report 1925, when it was proposed to 'convene an expanded conference of government officials to develop draft international treaties'.[49] The Financial Committee promptly accepted the proposal by instituting a Committee on Double Taxation and Tax Evasion and by mandating it 'to take into consideration the disadvantage of placing any obstacles in the way of the international circulation of capital, which is one of the conditions of public prosperity and world economic reconstruction'.[50] Despite the induction of fresh experts, LN Report 1927 largely trailed LN Report 1925.[51] Many ticklish issues that were deliberated at length e.g. agents' treatments, business profits' apportionment, and tax sparing were left open-ended. The position taken on the PE with underlying physical presence principle was enshrined into the international taxes regime with solid footprint. The International Chamber of Commerce (ICC), which was present on the big table throughout the proceedings, emphasized to ensure that the measures aimed at curbing tax evasion did not hamper free movement of capital.[52] The position taken by the Tax Experts Committee, and by implication, by Financial Committee on the issue of PE, was formalized into THE international standard, for, at least, the next hundred years.

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[44] Graetz and O'Hear 1997, *supra* note 39.
[45] Bret Wells and Cym Lowell, 'Income Tax Treaty Policy in the 21st Century: Residence vs. Source', *Columbia Journal of Tax Law*, 2013, 5(1): 1-39.
[46] Jogaranjan 2018, *supra* note 40.
[47] *Ibid.*
[48] League of Nations, *Double Taxation and Tax Evasion: Report and Resolutions Submitted by the Technical Experts to the Financial Committee of the League of Nations* (Geneva: Pub. for the League of Nations, 1925).
[49] Jogaranjan 2018, *supra* note 40.
[50] The Financial Committee Report to the Council on the Work of the Eighteenth Session, Geneva, 4-8 June 1925 - League of Nations Archives, C.335.1925.II - United Nations, Geneva.
[51] The Report of the Double Taxation and Tax Evasion Committee was submitted to the Financial Committee in London on 12 April 1927.
[52] Sunita Jogaranjan, 'Chapter 16. The Drafting of the First Model Treaties on Tax Evasion', in Peter Harris and Dominic de Cogan (eds.), *Studies in the History of Tax Law*, vol. 9 (Hart Publishing, 2019).

4.4. LN MTC 1928

The LN Reports 1923, 1925, and 1927 culminated into four MTCs[53] presented by the Tax Experts Committee[54] to Financial Committee on October 16, 1928. It is perhaps no coincidence of history that the MTC 'developed by the French and German representatives, has emerged as the prevailing model'.[55] Article 5 of LN MTC 1928, entitled 'Draft Bilateral Convention for the Prevention of Double Taxation', upfront creates a rock-solid nexus between the taxation of business income and PE by stating that 'income from any industrial, commercial or agricultural undertakings, and from any other trades or professions…is to be taxable in the countries in which the persons controlling the undertakings or engaged in the trade or profession, possess permanent establishments'.[56] In turn, 'real centres of management, branches, mining and oilfields, factories, workshops, agencies, warehouses, offices, depots, shall be regarded as permanent establishments'.[57] Although, the expression 'a fixed place' did not readily find place in the LN MTC 1928, yet the physical presence test impliedly underlies Article 5 for all practical purposes. Rao argues that though LN MTC 1928 'in theory granted the taxing power to the source country, that power was limited by the pattern of international flows of private capital in the form of portfolio investment income', and therefore there 'was relatively little direct investment which in the light of the newly formulated concept of "permanent establishment" would have been liable to a large degree of taxation in the source country'.[58] This way advanced capitalist economies exploiting a neutral multilateral forum, had a massive go at source state taxing rights effectively undermining the time-tested principle of territoriality.

4.5. LN MTC 1935

In view of the feedback received from various governments and cross-sections of the international community, LN MTC 1928 was put through extensive deliberations. The Draft Convention 'revised by Fiscal Committee in June 1935' never formally adopted, but was of great significance because of the importance of the issues with which it dealt.[59] In LN MTC 1935, though the scope of the PE was further refined, its basic rule was reinforced and supplemented with arm's length principle putting to rest the formulary apportionment method. The attributive nexus was created by ordaining that:

> If an enterprise with its fiscal domicile in one Contracting State has permanent establishments in other Contracting States, there shall be attributed to each permanent

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[53] These MTCs were entitled (i) 'Draft Bilateral Convention for the Prevention of Double Taxation'; (ii) 'Draft Bilateral Convention for the Prevention of Double Taxation in the Special Matters of Succession Duties'; (iii) 'Draft Bilateral Convention on Administrative Assistance in Matters of Taxation'; (iv) 'Draft Bilateral Convention on Judicial Assitance in Collection of Taxes'.

[54] The Committee was officially styled as the 'Committee of Government Experts on Double Taxation and Tax Evasion'.

[55] John A. Jones, 'Categorising Income for the Oecd Model', in Luc Hinnekens and Philippe Hinnekens (eds.), *A Vision of Taxes within and Outside European Borders* (Kluwer Law International, 2008).

[56] League of Nations, 'Report and Resolutions Submitted by the Technical Experts on Double Taxation and Tax Evasion', in League of Nations, *Publications of the League of Nations* (Geneva: Pub. for the League of Nations, 1927).

[57] League of Nations, *Model Bilateral Convention for the Prevention of Double Taxation in the Special Matter of Direct Taxes (1928 Draft)* (New York: League of Nations, 1928).

[58] M.B. Rao, *Taxation of Foreign Income: India's Double Tax Treaties* (New Delhi: Vikas Publishing House, 1997), at 7.

[59] Mitchell B. Carroll, *Global Perspectives of an International Tax Lawyer* (New York: Hicksville, 1978).

> establishment the net business income which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions.[60]

The PE was defined vide Protocol to the LN MTC 1935, to include 'the real centre of management, branches, mines and oil-wells, plantations, factories, workshops, warehouses, offices, agencies, installations, and other fixed places of business of an enterprise', and exclude 'a subsidiary company'.[61]

4.6. LN MTC 1943

The Regional Tax Conference (RTC) convened in Mexico City, in July 1943,[62] unveiled the *Model Bilateral Convention for the Prevention of the Double Taxation of Income* along with a *Protocol* (MTC 1943). It was stipulated that 'Income from any industrial, commercial or agricultural business and from any other gainful activity shall be taxable only in the State where the business or activity is carried out'.[63] However, in the event of business being carried on 'through isolated or occasional transactions, without…a permanent establishment', taxation rights were assigned to the residence state.[64] The PE was not defined any differently to include 'head offices, branches, mines and oil-wells, plantations, factories, workshops, warehouses, offices, agencies, installations, professional premises and other fixed places of business having a productive character'.[65] This way LN MTC 1943, fundamentally reversed the principle of taxation by re-instating the source rule and effective territoriality by enshrining that an enterprise will be liable to tax on its profits in a foreign country if it has carried out its business or activities in that country provided such activities did not merely take the form of isolated or occasional transactions.[66] This was a phenomenal divergence. It has been remarked that LN MTC 1943 'with its clear bias towards taxing rights for capital importing nations, won little support amongst high-income countries'.[67] The LN MTC 1943, signified a paradigm shift, but did not get the importance, publicity, and the weightage that it deserved, and for understandable reasons. With time a rightful dissension to the legal system that had been authorized by the powerful capitalist states on the weak and underdeveloped nations diluted and was consigned to the oblivion of history.

4.7. LN MTC 1946

No sooner key European capitalist powers were done with WWII, they scrambled to stock-take the developments and manage the shift that had taken place at the RTCs in early 1940s. The

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[60] League of Nations, *Draft Convention Adopted for the Allocation of Business Income between States for the Purposes of Taxation* (Geneva: League of Nations, 1935).
[61] *Ibid.*
[62] The RTC was attended by Argentina, Bolivia, Canada, Chile, Colombia, Ecuador, Mexico, Peru, USA, Uruguay, and Venezuela.
[63] League of Nations, M*odel Bilateral Convention for the Prevention of the Double Taxation of Income* (Mexico: League of Nations, 1943), art. IV, para. 1.
[64] *Ibid.*, art. IV, para. 2.
[65] *Ibid.*, Protocol, art. V.
[66] League of Nations, *Fiscal Committee: Report on the Work of the Tenth Session of the Committee* (London: League of Nations, 1946).
[67] Veronika Daurer and Richard Krever, 'Choosing between the Un and Oecd Tax Policy Models: An African Case Study', *African Journal of International and Comparative Law*, 2014, 22(1): 1-21.

Fiscal Committee convened in London to come up with the MTC 1946.[68] The LN MTC 1946 was recast to bring back into saddle the pre-MTC 1943 regime.[69] The LN MTC 1946 bugged territoriality full well and created a nexus for the taxation of business income by linking it to PE by holding that 'Income derived from any industrial, commercial or agricultural enterprise and from any other gainful occupation shall be taxable in the State where the taxpayer has a permanent establishment'.[70] The business income earned in the other state without a PE was expressly rendered non-taxable in the source state.[71] However, despite these merits, the position taken by the MTC 1943, was diametrically reversed vide MTC 1946. This is how the very superstructure of the extant international taxes regime was raised on perennially iniquitous foundations.

4.8. Transition

The PE principle, which was conceived in LN Report 1927 promulgated in MTC 1928, ripened through LN MTC 1935, LN MTC 1943, and LN MTC 1946, had reached the point where the UN had to take up and carry it forward. The UN, however, did not make a quick move to take the baton and resume LN's work, where it had left.[72] In fact, in a non-normative sense, the putting in place of an elaborate international taxes system with PE forming its pivot was a phenomenal work, the true importance and worth of which from the point of view of survival and thrival of capitalism, is yet to be realized. At some level, during the inter-war period, future of the world was shaped by tax experts and not by generals, strategists, and philosophers – for what length of time; only time would tell.

5. Post WWII PE

The Organization of European Economic Cooperation (OEEC), which had been created in 1948, established a Fiscal Committee in March 1956, and tasked it to prepare a MTC, and a concrete set of proposals to implement it.[73] In September 1961, the OEEC became OECD and within two years published the OECD MTC 1963. Thus, the vacuum created by the UN's withdrawal in the fiscal domain was eagerly filled in by the OEEC. It has been argued that the true heir of LN's extensive work on international taxation was OECD, and not UN as is generally mistakenly believed.[74] Given the stakes involved, the capitalist world substantially invested in the OECD, and capacitated it enough to churn out dominant ideas which could capture almost entire epistemological space in the international fiscal domain.

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[68] League of Nations 1946, *supra* note 66.
[69] 'Fiscal Committee - London and Mexico Model Tax Conevtions Commentary and Text - C.88.M.88. 1946.A.Ii (Geneva, November, 1946)', available at http://adc.library.usyd.edu.au (accessed 22 August 2020).
[70] League of Nations, *Model Bilateral Convention for the Prevention of the Double Taxation of Income and Property* (London: League of Nations, 1946).
[71] *Ibid*.
[72] Ahmad Khan, *Corss Border Transactions and Tax Treaties Theory and Practice* (Singapore: Petrosin, 2000).
[73] Ahmed 2020, *supra* note 4.
[74] *Ibid*.

5.1. UN MTC's PE

Once the dye had been cast, the UN ended up crating an Ad-Hoc Group of Experts on Tax Treaties in 1967.[75] The very nomenclature of the Group betrays an underlying urge to rectify fiscal inequities extant in the international taxes regime between developed and developing UN member states. The 1st UN MTC was published in 1981, with 'a fixed place' forming the very pivot of Article 5, linking taxation of business income to the PE principle, thereby effectively reinforcing the perverse compromise on the principle of territoriality. The UN MTC went through some modifications in 1999, 2001, 2007, 2011, and 2017, but without ever touching the 'fixed place' standard and the PE principle. The basic-rule PE implying 'a fixed place of business through which the business of an enterprise is wholly or partly carried on' as enshrined in UN MTC Article 5, paragraph 1 emphasizes its vitals as a 'place of business' with a designated locale or 'situs'. The definition of PE subsumes (a) the existence of a 'place of business', that is, a facility such as premises, machinery or equipment; (b) this place of business is 'fixed', that is, it is established at a distinct location with a definite degree of permanence; and (c) the business of the enterprise is carried through this fixed location.[76] Albeit, these pre-conditions were already stringent enough for the source state to raise and enforce a PE, systematic efforts were made to dilute it further.

The PE under UN MTC while preserving the pivot – the fixed base, has undergone modifications on a few peripheral counts over the past decades. Cockfield gleaning on Skaar observed that 'the principle has undergone a significant dilution during the past half-century to take into account emerging commercial practices', and that 'Enhanced global trade, the rise of the service sector, increased mobility of capital, and other factors of production all contributed to a perceived need to modify the physical presence requirement of the traditional PE'.[77] Contrarily, it is posited that most modifications to PE principle were brought in to further taper off taxing rights of developing source states; at best, those were introduced as vent-valves to take pressure out systematically so as to preserve the hierarchically-oriented international taxes regime.

5.2. OECD MTC's PE

The PE as defined in the OECD MTC 1963, continued to hold water barring select modifications to the text or the Commentary. In 1977, the scope of 'place of business' was expanded to rope in any premises, facilities or installations used for carrying on the business, if used exclusively for business or even if no premises were available. The 'Construction PE' was introduced to cover a building site, construction, installation project, which lasted more than 12 months. In consequence to the deletion of Article 14 on 'Independent Personal Services' in 2000, the criteria set to determine a PE and tax business profits was also extended to income from professional services. In 2003, to take stock of the fast-dawning reality of e-commerce, the concept of PE, with reference to computer equipment, was addressed in the Commentary.

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[75] The 'Ad-Hoc Group of Experts on Tax Treaties between Developed and Developing Countries' was established under ECOSOC Resolution 1273 (XVIII) adopted on 4 August 1967.

[76] OECD, *Commentary on the Model Tax Convention on Income & on Capital* (Paris: OECD Publishing, 2017), at 117.

[77] Cockfield 2003, *supra* note 32.

Likewise, in 2008, ‘Service PE’ was introduced in the Commentary as an alternative provision for countries that were not eager to espouse exclusive residence-based taxation on service income. Thus, Article 5 materially continued to be unaltered since 1977 until 2017, when it was substantially amended to reflect proposals finalized under the BEPS initiative.[78]

The PE as conceived and delivered by the LN, reared by the OECD and baptized by the UN, provided an angularly loaded yardstick of determining and sharing of taxing rights between nation states. Cockfield remarks that PE always facilitates ‘nonresident firms to generate significant revenue in foreign markets without the need for a physical presence’.[79] If that was not enough, an ever-increasing conundrum of caveats was cast around the concept rendering the determination of whether ‘fixed place of business’ had existed long enough for it to constitute a PE.[80] The design of the PE, in its current form, is complex, conditional, and contingent upon various manipulable variables the result being the tempering of the basic rule PE to fit the operating needs of the capitalist conglomerate.

5.3. UN MTC’s Deviations

Admittedly, UN MTC Article 5 is essentially based on OECD MTC Article 5 with ‘several significant differences’[81] that the study reckons as over-blown. The basic framework of the PE principle was provided by the LN and the OECD, and the UN stepped in with trifling cosmetic variations. Rohatgi has aptly remarked that UN MTC has been subject of censure due to its failure to make any sizable impact on the way developing countries have negotiated and signed DTCs for which one of the important reasons could be that it has subserviently trailed OECD MTC.[82]

5.4. International Consensus

The fiction of PE, despite being dicey, is currently the linchpin of the entire tally of over 3000 international bilateral and multilateral agreements,[83] and helps define, determine and distribute taxing rights amongst jurisdictions on incomes earned through cross-border business operations by an ever-increasing number of MNCs and firms. Intriguingly, UN MTC’s capitulation to the PE principle does not come in isolation. In fact, there is an international consensus prevailing as regards taxation of business income earned across borders by attributing it to PE manifesting in ‘a fixed place’. The OECD MTC Article 5(1) likewise ordains that ‘the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on’.[84] The US MTC Article 5(1) is in complete consonance with UN

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[78] See, for a comprehensive analysis, Muhammad Ashfaq Ahmed, ‘Pakistan: Bracing for B.E.P.S’, *Intertax*, 2020, 48(3): 329-45.
[79] Cockfield 2003, *supra* note 32.
[80] J. Martens-Weiner, *Company Tax Reform in the European Union: Guidance from the United States and Canada on Implementing Formulary Apportionment in the EU* (Springer US, 2006), at 300.
[81] *United Nations Model Double Taxation Convention between Developed and Developing Countries 2017*, *supra* note 1.
[82] R. Rohatgi, *Basic International Taxation* , vol. II (London: Kluwer Law International, 2002), at 60.
[83] Multiple expressions like ‘treaty’, ‘convention’, ‘framework’, and ‘agreement’ are used to describe the same phenomenon; in the interest of simplicity and general understanding.
[84] OECD, *OECD Model Tax Convention on Income and on Capital* (Paris: OECD Publishing, 2017), art. 5(1).

MTC and OECD MTC on this count.[85] This consensus at the conceptual level, over the past hundred years, has exhibited even greater incidence at practical level; all about 3000 bilateral DTCs signed between states are woven around the PE principle centered on fixed place. This is a massive number of DTCs and the transfer of resources from the developing to the developed countries on account of managed non-PE cases could be mind-blowing. The international consensus on PE principle amongst UN MTC, OECD MTC, and US MTC has an obvious pro-developed state bias, and, though empirically intractable, yet evidently has contributed inestimably towards embedded underdevelopment in parts of Africa, Asia, and South America, and correspondingly towards accumulation of capital and strengthening of capitalism in Europe and North America.

5.5. Collective Bargaining – Failure

The consensus on vesting taxation rights on international business in the state of residence until it passes the PE test by OECD MTC and US MTC is quite explainable as most of the technically-advanced and financially-resourced MNCs are based in those well-developed capitalist economies. The OECD MTC even admittedly promotes financial and fiscal interests of the advanced economies. The US MTC, likewise, is understood to promote and protect economic interests of the US fisc by taxing US enterprises wherever those may be operating. However, it was the UN MTC's professed position and responsibility to promote fiscal interests of developing countries as understandably they could not do so on their own due to capacity constraints, and its brazen capitulation into effectively surrendering source taxation on business by tethering it to PE based on physical presence was nothing less than a grand failure with far-reaching implications. It has been argued that UN MTC's spineless convergence with the OECD MTC and US MTC could well be equated with failure of collective bargaining function that UN espouses unto itself.[86] Pastukhov, commenting on UN MTC, avers that developing countries did contribute towards its development, yet 'the final draft has become a mere extension or a variation of the OECD MTC', and wherefore, 'Collective bargaining has also not been successful so far'.[87] More threatening specter may be that the status quo is showing no signs of weakening as he goes on to observe that 'developing countries,…disadvantaged by the current regime of international taxation, do not have much bargaining power to influence the redesign of the existing international economic order'.[88] Rocha posits that as 'the position of the developed countries prevailed, the UN Model…failed to achieve its objective of fairly distributing taxing rights between developed and developing countries'.[89] It has been posited that 'current regime of international taxation is a compromise among the developed nations, which have the greatest resources and bargaining power to influence the world trade negotiations'.[90] Valderrama et al point out that in view of 'the leading role of the OECD,…the

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[85] US, *United States Model Income Tax Convention* (Washington DC: US Treasury, 2016).
[86] Ahmed 2020, *supra* note 4.
[87] Oleksandr Pastukhov, International Taxation of Income Derived from Electronic Commerce: Current Problems and Possible Solutions, *BUJ Sci. & Tech. L.* 2006, 12.
[88] *Ibid*.
[89] Sergio Andre Rocha, 'International Fiscal Imperialism and the "Principle" of the Permanent Establishment', *Bulletin for International Taxation*, 2014, 68(2).
[90] Pastukhov 2006, *supra* note 87.

UN on profit shifting and tax avoidance have been unsuccessful'.[91] It is, therefore, apparent that the UN MTC legitimizes past plunder, adversely promotes the present iniquitous international taxes regime, and promises nothing halcyon for the future to the developing world.

5.6. Evaluation

Territoriality apart, counter-assertions in favor of source taxation have also been made on normative and academic grounds. Skaar, justifying source state taxation rights, contends that a PE is merely an evidence of economic allegiance, and not the reason for source-state taxation, which requires all enterprises that obtain economic benefits from a state to contribute correspondingly to that state irrespective of the fact if it has a PE therein or not.[92] Likewise, Pinto resonates Skaar to argue that 'even if a business does *not* have physical presence in the source country, the business benefits *substantially* from its infrastructure and therefore *should* make a contribution to the source country, consistent with the benefit theory of taxation'.[93] Moreover, even at multilateral level source rule sans conditions has been asserted, at least, on two occasions. First, LN MTC 1943, which stipulated taxation rights in favor of the source state. Friedlander and Wilkie, with reference to the LN MTC 1943, assert that states had 'an interest, both for themselves as nations and on behalf of their nationals, in avoiding impediments to trading relationships and commercial activity', yet it was considered imperative that 'their national interests are well served…in attracting capital investment, by recognizing their reciprocal tax interests'.[94] Second, AC MTC which upheld territoriality by stating that 'Regardless of nationality or domicile of the persons, income of any kind obtained by them shall be taxable only in the Member Country in which such income has its source of production, barring the cases of exception provided for in this Decision'.[95] The fact remains that either such deviations were marginalized or silenced through preponderant counter-concepts powered by vibrant force of capitalism, particularly, when the communists could not figure out how to deal with missing component in Marx's conceptual framework and Neo-Marxists could not keep pace with capitalists' intellectual work done at a rattling pace in the arena of international taxation – this being the matter of capitalism's survival.

Cockfield's halcyon measure of the PE principle in that it 'has shown remarkable resiliency, forming an accepted international income tax law principle since its inception roughly 100 years ago',[96] is visibly tantamount to oversimplification of rather a hugely loaded and complex phenomenon. This over-simplification tends to belittle both constructive and destructive potentials of the PE principle: constructive in the sense that it supplied a common

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[91] I.J. Mosquera Valderrama, Dries Lesage, and Wouter Lips, *Tax and Development: The Link between International Taxation, the Base Erosion Profit Shifting Project and the 2030 Sustainable Development Agenda* (Brussels: United Nations University, 2018).
[92] Arvid Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle*, ed. Taxation Law (AADR: Wolters Kluwer, 1991), at 559.
[93] Dale Pinto, 'The Need to Reconceptualize the Permanent Establishment Threshold', *Bulletin for International Taxation*, 2006, 60(7): 266-79.
[94] Lara Friedlander and Scott Wilkie, 'Policy Forum: The History of Tax Treaty Provisions - and Why It Is Important to Know About It', *Canadian Tax Journal*, 2006, 54(4): 907-21.
[95] Andean Community, *Model Convention for the Avoidance of Double Taxation between Member Countries and Other Countries Outside the Andean Sub-Region* (Lima, Peru: Commission of Andean Community, 2004), art. 3.
[96] Cockfield 2003, *supra* note 32.

platform to nation states to de-conflict their fiscal disputes; destructive in the sense that it singly legitimized tax-free out-remittance of trillions of dollars legitimately belonging to denizens of developing countries on account of bugged territoriality. The PE may be one of the most powerful operational concepts devised by human mind over the past few centuries – worthy to be equated with conceptual leviathans like the state, money, colonialism, MNC, slavery, and imperialism.

6. PE – The Plunder Pulley

Once the PE had been laid-out, the capitalist state needed an operational framework to optimize on it. The solution devised was the MNC, which was to cut loose and ply on it to drive home the near-total fiscal fruits of the international business system that evolved and expanded at an exponential pace throughout the 20th century.

6.1. The MNC

The international system exhibits two kinds of actors – state actors and non-state actors. While state actors do not warrant further explication, non-state actors could be both official and non-official actors;[97] the MNC falls somewhere in the middle. The MNC could be differently depending upon spatial, temporal and operational imperatives,[98] but contextually it implies an incorporated entity, which owns or controls production, distribution, or delivery of goods or services, at least, in one state other than its home-state.[99] Historically, MNC was contrived 'to undertake colonial expeditions at the behest of their European monarchical patrons'.[100] In fact, this was true of most continental powers.[101] Although, the early MNC 'facilitated colonialism by engaging in international trade and exploration, and creating colonial trading posts',[102] yet there were others that played a direct role in formal colonization by creating and maintaining colonies. Taxation apart, the early MNC created differential economic outcomes between home countries and colonies through exploitation of latter's resources, raw materials, labor, and investment of economic surplus in the home country.[103] The 'end result of this process was the enrichment of the colonizer and the impoverishment of the colonized'.[104] To Howe, economic impact of MNC-led colonial exploitation has proven to be lasting and far-reaching,[105] and that this impact is amongst the major reasons behind contemporary global income inequality.[106]

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[97] Of late, scholarly analyses have emerged dubbing the MNC as 'stateless'. See, for instance, William J. Holstein, 'The Stateless Corporation', *Business Week*, 14 May 1990; Roy D. Voorhees, Emerson L. Seim, and John I. Coppett, 'Global Logistics and Stateless Corporations', *Transportation Practitioners Journal*, 1992, 59(2): 144-51.
[98] The MNC could also be dubbed as a 'a multinational enterprise' (MNE); 'transnational enterprise' (TNE); and a 'transnational corporation' (TNC).
[99] Voorhees, Seim, and Coppett 1992, *supra* note 97.
[100] Alex Jeffery and Joe Painter, *Political Geography: An Introduction to Space and Power* (London: Sage, 2009).
[101] Illustratively, such MNCs included British East India Company, Swedish Africa Company, and Hudson's Bay Company.
[102] John Micklethwait and Adrian Wooldridge, *The Company: A Short History of a Revolutionay Idea* (New York: Modern Library, 2003).
[103] Stephen Howe, *Empire: A Very Short Introduction* (Oxford: OUP, 2002).
[104] Luis Angeles, 'Income Inequality and Colonialism', *European Economic Review*, 2007, 51(5): 1155-76.
[105] Howe 2002, *supra* note 103, at 78.
[106] Angeles 2007, *supra* note 104.

The MNC understandably enjoys greater influence and invites harder criticism as compared to the corporation – a domestic enterprise. The MNC can take advantage of economies of scale by distributing research, development, and advertising costs over their global sales, pooling global purchasing power over suppliers, and utilizing their technological and managerial know-how globally with minimal additional costs.[107] Likewise, MNCs can exploit their global footprint to drive home the advantage of cheap labor force available in developing countries, and simultaneous access to research facilities in advanced countries.[108] Post-colonial scholars also tend to place MNC operations in developing countries 'within the broader context of neocolonialism'.[109] Intriguingly, the evolution and success of MNC has a close parallel with that of capitalism. The MNC has historically engaged itself in the import and export of goods and services across nations and continents, investments in foreign jurisdictions in most business domains that is, sale, purchase, leasing of intangibles, contract execution, manufacturing, and assembly operations on foreign soils.[110]

Thus, MNC has pertinently been dubbed as 'the vanguard of the liberal order'.[111] In order to oversee and regulate the MNC, the UN vide Resolution 1913 (LVII) ended up establishing the Commission on Transnational Corporations (CTC) in 1974. The CTC was to develop code of ethics for MNCs, regulate their affairs, and provide technical cooperation to developing countries to enable them to deal with MNCs. The CTC was wound up under intriguing circumstances at the behest and insistence of the US and other major capitalist powers in 1993. Resultantly, in MNC-propelled global economy, the capitalist is increasingly being able to play workers, communities, and nations off against one another as they demand wage, regulation and tax, respectively, while threatening to move, leaving behind enhanced economic inequality, unemployment, and wage stagnation.[112] This is how then the PE, in combine with MNC, was unleashed to plunder on developing countries, which process has continued for over the past hundred years.

6.2. PE's Predation

Although PE has been oblique target of criticism for rather blatantly relocating taxation rights from source state to residence state,[113] yet its adverse fallouts for the developing countries have rarely been appraised systematically; hence, the ensuing stipulations.

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[107] Cheol S. Eun and Bruce G. Resnick, *International Financial Management*, vol. 6 (Beijing: Chengxin Weiye Printing Inc., 2014).
[108] *Ibid*.
[109] Abayomi Azikiwe, 'Burkina Faso: Masses Rise up against Neo-Colonial Rule', (Global Research: Centre for Research on Globalization, 2014).
[110] Eun and Resnick, *supra* note 107, at 6.
[111] Karen A. Mingst, *Essentials of International Relations* (W. W. Norton & Company, 2014).
[112] Epstein Crotty, *Multinational Corporation in Neo-Liberal Regime* (London: Cambridge University Press, 1998), at 2.
[113] Sergio Andre Rocha, 'Should Developing Countries Include Article 7 in Their Tax Treaties?', *Bulletin for Interantional Taxation*, 2017, 71(7).

6.2.1. PE's design exploitability

There is no cavil that PE principle is inherently amorphous, fluid and manipulable, and has induced substantial scholarship geared to unravel its various layers and mysteries.[114] The work done under the OECD BEPS Action 7 admittedly stipulates that PE is conveniently avoidable on, at least, four counts, namely (a) dependent agent PE; (b) auxiliary and preparatory work framework; (c) fragmentation of business into bits; and (c) splitting of contracts.[115] The realization may have come at some cost to developing countries. The built-in fungibility of PE conveniently allowed large chunks of income earned in source states to be 're-packaged and disguised in order to move it out of spheres of state oversight, regulation and taxation'.[116] The design exploitability latent in the very concept of PE diverted maximum energy of developing countries on how to *have* PEs of MNCs operating in their territory. Contrarily, the MNC utilized substantial amount of resources on how *not to have* PE in developing source states. The matter is equally applicable at intra-developed world level, but its oppressive implications are far more pronounced for developing countries due to asymmetric economic relations. In fact, the largest tally of cases that have been contested, in the international taxes domain, at various high legal forums globally, pertain to the existence or non-existence of PE in source states.

This potentially could have produced five significant outcomes. One, it created a deadweight loss equal to the amounts MNCs spent on avoiding having PEs in source states plus the costs borne by source states on counter-establishing PEs of reluctant MNCs in their jurisdictions. Two, it resulted in a revenue loss potentially amounting to trillions of dollars transferred from developing countries through deftly planned avoidance of PE presence. Three, the welfare loss equal to amounts siphoned off from developing countries but not repatriated to the beneficial residence states and parked in tax havens. Four, PE design fungibility led to scenarios of moral hazard wherein when the MNC knew as to what would render it liable to tax in the source state, it would be at complete liberty to contrive its structures and transactions, accordingly. Five, the inherent manipulability of PE design incentivized domestic corporations to go international for perverse and non-business reasons. It is an admitted fact that developing countries' tax administrations, mostly operating under serious capacity constraints, have rarely been equal to the sophisticated ploys that MNCs put in place to avoid having PEs in their territories. This capacity mis-match between MNC and developing country tax administrations has further reinforced PE's oppressive implications.

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[114] See, for instance, Skaar 1991, *supra* note 92; Kobetsky 2011, *supra* note 19; Radhakishan Rawal and Neha Bagri, 'Permanent Establishments in the Construction Industry', *INTERTAX*, 2009, 37(12):698-700; Guglielmo Maisto (ed.), *New Trends in the Definition of Permanent Establishment*, EC and International Tax Law Series vol. 17, (Amsterdam, 2019); OECD, *Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce?* (Paris: OECD Publishing, 2004); OECD, *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7- 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (Paris: OECD Publishing, 2015); Pinto 2006, *supra* note 93.

[115] OECD 2015, *ibid.*

[116] A. Waris and L. Abdul Latif, 'The Effect of Tax Amnesty on Anti-Money Laundering in Bangladesh', *Journal of Money Laundering Control*, 2014, 17(2):243-55.

6.2.2. Export of capital

At the dawn of the 20th century, capitalism – the most powerful economic system so far conceived and developed by human mind – found itself at an existential inflection point. The capitalist mode of production having operated on full throttle for a time had started to show signs of slow-down in the wake of a draining raw material base and dwindling aggregate demand leaving large amounts of investible surplus capital un-invested within the capitalist world. At some level, in the distant backdrop, the system of colonization was exhibiting signs of stress, too. The cyclical low, inter alia, gave rise to the mutually reinforcing twin-phenomena of surplus investible capital coupled with declining interest rates. In the capitalist heartland, starting in late 1880s through WWI, average real interest rate had fallen to 2.2 percent.[117] In fact, the interest rate did not change much over the turn of 20th century, as even 'in 1919-39, the global real interest was a whisker lower than the global growth rate'.[118] Keynes exploring into the accelerated bulge of accumulated capital in the European society contends that the 'new rich of the nineteenth century were not brought up to large expenditures, and preferred the power which investment gave them to the pleasures of immediate consumption', and 'like bees they saved and accumulated'.[119]

Like already premised that the centerpiece of internationalization of capitalism, and by implication, neo-colonization was PE, in particular, and international taxes regime, in general. Logically, an effective mechanism was devised through which opportunities could be created for profitable investment of the surplus capital, simultaneously ensuring cost-effective supply of raw materials in the visibly decolonizing world, and sustain the dwindling aggregate demand. This immediate capitalist imperative was systematically seeded into Article 3 of LN MTC 1928; it was ordained that 'Income from public funds, bonds, including mortgage bonds, loans and deposits or current accounts, shall be taxable in the State in which the debtors of such income are at the time resident'.[120] This way, the taxation of capital-investing enterprises was ingeniously linked to the very factum of having a PE implying that in the absence of PE no taxation would take place in the source state. A century ago, it must go down as a paradigm shift in international affairs; it displaced and supplanted the time-tested principle of territoriality. The dispensation handed down in 1928 stayed materially unchanged in LN MTC 1935, LN MTC 1943, and LN MTC 1946.

Post WWII, the dispensation was given a semblance of inter-nation equity through the OECD MTC 1963 by inserting therein Article 11 allowing the source state taxation rights on interest income up to 10 percent, but if the debt-claim was 'effectively connected as an asset of a permanent establishment in Contracting State of a beneficial owner resident in the other Contracting State',[121] the interest income would be taxed as business income under Article 7.[122] Once the interest income was exempted from tax, pressure started to build for extending

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[117] L. Catão and G. Mackenzie, *Perspectives on Low Global Interest Rates* (Washington DC: IMF, 2006), at 8.
[118] *Ibid.*
[119] J.M. Keynes, *The Economic Consequences of Peace* (Lanham: Start Classics, 2014), at 11.
[120] League of Nations 1928, *supra* note 57.
[121] R. Rohatgi, *Basic International Taxation*, vol. I (Richmond, U.K.: Richmond Law & Tax, 2005), at 151.
[122] OECD, *Draft Model Taxation Conveion on Income and on Capital* (Paris: OECD Publishing, 1963).

exemption to other types of incomes also ‘on the ground that such a policy distorts the flows in the financial and capital markets’.[123] It has been argued that MNCs in the business of lending would exploit this provision to erode the fiscal base of the developing countries by padding up expenses.[124] The UN MTC 1981 subserviently adopted this provision creating an illusionary trap for developing countries. The convergence amongst the OECD MTC 2017, UN MTC 2017, and US MTC 2017, has practically attained the status of international consensus on the issue.

This way the capitalist state drove home a couple of significant advantages. First, it created for the capitalist vast vistas for endless opportunities in under-developed world to deploy surplus capital, and, in most cases, at above-par interest rates as there was a lot of appetite for investment in the post-colonial world. Most times, the borrowing states underwrote the credit being invested in profit-seeking private entrepreneurs; it rendered the process absolutely risk-free. Second, under the facilitative tax regime so laid out there was practically only a miniscule opportunity left with the administratively constrained developing countries to execute taxation on vast amounts of interest incomes arising within their territorial jurisdictions.[125] Soon, however, the chickens came home to roost when the MNC having first predated on developing nations did not shift back the bounty to capitalist state but to tax haven.

6.2.3. PE nexus – purchase function

The capitalist mode of production needs uninterrupted supply of raw material to sustain itself and churn out finished products, sell them, earn profits, and accumulate capital. The depletion of raw material within national frontiers compels firms to search for and obtain it from other countries. Marx had predicted, and equated the transition with internationalization of capitalism. Lenin, in early 20th century, likened it to imperialism of capitalism.[126] Since economic interests of the capitalist and the capitalist state completely converge on this count, they jointly sponsored subtle modification to the definition of PE to exclude the function of ‘purchasing’ from its purview, which, in the long run, was to have far-reaching consequences for the developing world. To Kobetsky, the original configuration of the PE evolved in the intra-Prussian context did cover ‘purchasing’, as at the time of codification ‘permanent establishments included business undertakings, branch operations and places for purchasing’,[127] as well as the ‘business operations carried on through an agent and a place of business maintained for purchasing’.[128] The matter did come up under discussion with LN Fiscal Committee but remained inconclusive ‘on the point whether purchasing offices or sales offices are to be considered as places of business’, majorly because it was reckoned to be ‘a question of fact’.[129] In reality, this never was a question of fact; it was always a question of law – point of fact only trails point of law. The LN’s gravitation towards effectively excluding ‘purchasing’

[123] V. Tanzi, *Taxation, Inflation, and Interest Rates* (Washington DC: IMF, 1984), at 29.
[124] Muhammad Ashfaq Ahmed, Na Li, and Peter Mellor, ‘China-Pakistan Double Taxation Agreement and China-Pakistan Economic Corridor’, *Bulletin for International Taxation*, 2018, 72(8).
[125] Katrin McGuaran, *Should the Netherlands Sign Tax Treaties with Developing Countries?* (Amsterdam: Centre for Research on Multinational Corporations (SOMO), 2013).
[126] Lenin 1917, *supra* note 14.
[127] Kobetsky 2011, *supra* note 19, at 110.
[128] *Ibid.*, at 111.
[129] League of Nations 1927, *supra* note 56.

was complete by 1933, when it was unequivocally held that an enterprise, which manufactured items from raw materials, in fact, did not realize any profits until the goods had been sold.[130] This implied that raw material purchased through a PE or an agent of enterprise in the other state would not give rise to chargeability of tax in that state.

Admitting the fact that the 'case of purchasing offices deserves special mention', it was stipulated that 'when goods are bought in a country, the profits should be divided between the two functions of purchase and sale just as they are divided between manufacture and sale', and therefore, 'to exempt purchasing establishments of foreign enterprises would constitute a discrimination against domestic exporters'.[131] However, then on the 'purchasing function' of the PE was systematically and surreptitiously evicted from its purview as well as the agenda of international tax debate. The OECD MTC Article 5 expressly debarred that 'no profits should be attributable to the purchasing activity'.[132] The UN MTC Article 5 readily reflected this position by containing an unequivocal formulation to the effect that 'No profits shall be attributed to a permanent establishment by reason of mere purchase by that permanent establishment of goods or merchandise for the enterprise'.[133] The exclusion of 'purchasing' from the purview of PE, it appears, wheedled developing countries into first allowing shipment of raw material without taxing them, and then receiving finished products back into their markets as exports, in the process, letting the foreign industrialist go scot free of the developing country taxation.

The course correction appears emerging on the horizon as under the new definition of PE 'such local places of business will constitute a PE, as the purchasing function is an essential and significant part of the enterprise's overall activity (consisting of selling these goods)'.[134] This could now mean that raw materials purchased for import either through an agent or an office in the other country could give rise to chargeability of tax in the other state. However, the inestimable revenue loss already caused to the developing source states would never possibly be recouped.

6.2.4. PE nexus – export of goods

When capitalism made moves to internationalize in the wake of dwindling aggregate demand in its heartland, ways and means had to be found to profitably sell finished goods in the developing world, and at least overhead costs – contextually taxes. With PE and MNC having already been rolled out, an ever-growing banking system was leveraged to contrive the instrument of letter of credit (LC). The LC is a payment mechanism used in international trade to provide a valid guarantee from credit-worthy financial institutions to an exporter of goods.[135] The LC is of huge importance in situations where the reliability of contracting parties

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[130] League of Nations, *Taxation of Foreign and National Enterprises* (Geneva: Fiscal Committee, 1933).
[131] League of Nations, *Commentaries on Mexico and London Draft* (Geneva: League of Nations, 1946).
[132] Radhakishan Rawal, *The Taxation of Permanent Establishments: An International Perspective* (Spiramus, 2006), at 155.
[133] UN, *United Nations Model Double Taxation Convention* (New York: Department of International Economic & Social Affairs, 1980).
[134] OECD 2017, *supra* note 76.
[135] The LC is also known as a Documentary Credit (DC), Bankers' Commerical Credit (BCC), or Letter of Undertaking (LOU).

cannot be remotely determined, and the buyer and seller may not know each other personally and are separated by distance, differing laws in each country, and varying trading customs.[136] Essentially, under an LC arrangement a bank underwrites and assumes the credit risk of the buyer by paying the seller for goods as per the terms committed in the commercial contract. The initial LC framework was developed in 1933 under the direct oversight of the ICC.[137] The timing of the evolution of the PE and the LC is interestingly fortuitous, and the role played by the ICC in the development of both is intriguingly coincidental.

The LC proved a game-changer as international trade grew exponentially over the next decades, but it did something else, too; something fantastic; something extraordinary – it simply took out the need to have a PE in foreign lands to sell finished goods. This way a cobweb of international tax laws was put in place where-under the import of raw materials became tax free as 'purchase' function had been evicted from PE's nexus, the export of finished goods through LC became tax free, and freight income became tax free with shiplines having been let of the PE's hook under UN MTC Article 8. These were apparently different parts operating in isolation, but in reality they formed a well-oiled machine to support a self-sustaining system of exploitation on part of capitalist state to predate on developing world. The UN MTCs' near-complete trailing of the OECD MTC helped create a lopsided international trade and business environment, the fiscal fruits of which have completely been unevenly distributed over the past century.

6.2.5. Treaty shopping

The international taxes regime, primordially cast around PE, proffered MNC built-in strategic space to maneuver its legal structures in such a way to hop on and shop the most conducive of the treaties available and legally transfer out the economic surplus. The UN defines 'treaty shopping' as 'a form of improper use of tax treaties…through which persons who are not entitled to the benefits of a tax treaty…indirectly access these benefits'.[138] Probably, the most significant dynamic of shopping is the treaty which best helps avail having a PE in source state. The PE has always been a fungible arrangement – subject to convenient maneuvering, manipulation, and shopping with fiscal implications way beyond generally approximated. It has been contended that 'international tax system is a complex regime composed of thousands of bilateral tax treaties', whereby 'states have inadvertently created opportunities for treaty shopping by multinationals', which 'opportunities, in turn, reduce the potency of fiscal policy, put pressure on governments to change their domestic tax laws, and ultimately constrain state autonomy'.[139] It has been asserted that 'though tax evasion and avoidance were already identified in the 1920s as a fundamental and emerging problem, most tax treaties did not contain

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[136] Aaron Larson, 'How Do Letters of Credit Work' *Expert Law* (6 April 2018), https://www.expertlaw.com/library/finance/letter_of_credit.html (accessed 22 August 2020).

[137] Horace M. Chadsey, 'Practical Effect of the Uniform Commercial Code on Documentary Letter of Credit Transactions', *University of Pennsylvania Law Review*, 1954, 102(5):618-28.

[138] *United Nations Model Double Taxation Convention between Developed and Developing Countries 2017*, *supra* note 1, at 87.

[139] Vincent Arel-Bundock, 'The Unintended Consequences of Bilateralism: Treaty Shopping and International Tax Policy', *International Organization*, 2017, 71(2):349-71.

specific provisions dealing directly with treaty shopping'.[140] In spite of the fact that both OECD and UN have long been trying to develop anti-abuse measures and deal with treaty shopping in their commentaries, they failed to include in their MTCs specific anti-abuse articles.[141] It is manifestly evident that developed countries were fine with this shadowy regime of treaty shopping as long as developing countries were the target but as soon as MNC turned back at the capitalist state, BEPS occurred.

6.2.6. Construction & service PE

The two of the most common business types that MNCs undertake in jurisdictions other than their own are rendering of services and construction.[142] The LN's pioneering work on international taxes is almost completely silent on these sub-categories of business income. In 1977, OECD MTC stepped in to create an exception to basic rule PE by enshrining therein that 'A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months',[143] meaning thereby that any 'building site, construction or installation project' will not give rise to taxability in the source state if it was in existence for less than a year. The UN MTC readily espoused this position but by reducing the time limit to six months. The UN MTC also did something extraordinary; it roped in:

> The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only where activities of that nature continue (for the same or a connected project) within the country for a period or periods aggregating more than six months within any 12-month period.[144]

This was yet another exception to the basic rule PE cast in a couple of critical caveats, which allowed ample space to MNC to undertake aggressive tax planning. Both UN MTC and OECD MTC continue to maintain their respective positions with developing countries caught in a state of paradigm paralysis – complete elimination of alternatives. It is stipulated that first PE was contrived to effectively undermine territoriality by imposing curbs on taxation rights of source states yoked in asymmetrical bilateral frameworks, and then by putting time thresholds on two specific yet important business types to raise chargeability in source state reinforcing lopsidedness in international taxes regime.

6.2.7. 'Force of attraction' forays

Once PE with all its exploitative potential had seeped into the structures of the international taxes system, the taxability that could be loaded on it and executed in source state was further diluted by contriving angular doctrines and principles. The OECD MTC 1963 enshrined attribution by stating that 'If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that

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[140] McGuaran 2013, *supra* note 125, at 16.
[141] *Ibid.*
[142] While OECD MTC still does not take cognizance of the matter in any comphrehensive manner, UN MTC included Article 12A 'Fees for technical services' only in 2017.
[143] OECD, *Model Double Taxation Convention of Income and on Capital* (Paris: OECD Publishing, 1977), art. 5, para. 3.
[144] Article 5, Paragraph 3 of *United Nations Model Double Taxation Convention 1980*, *supra* note 133.

permanent establishment'.[145] It was further explicated that only those profits would be attributed to PE 'which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment'.[146] The UN MTC made an attempt to bring in and expand the force of attraction principle, stating:

> If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to *(a)* that permanent establishment; *(b)* sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or *(c)* other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.[147]

But UN MTC's expanded force of attraction principle has not been of much help due to 'the stronger negotiating powers of OECD member countries'.[148] Both UN MTC and OECD MTC continued to broadly hold their respective positions until BEPSization of OECD MTC 2017 through which an attempt was made to arrest the situation by incorporating anti-fragmentation and anti-project splitting rules and correct the wrong done a century ago, with UN MTC 2017 mutely trailing.

6.3. Semantic Occupation

The international taxes regime as woven around PE was inevitably cast in developed-developing country binary, which typically reflected control of the lexicon in which the latter could conceptually approach the matter and enter into deliberations with the former in the critical arena of distribution of international fiscal rights. The Neo-Marxists remained oblivious of the semantic occupation of the vast expanse of extractive function of the state that the capitalists rushed in to fill and monopolize. The capitalist state, capitalist, and capitalist non-state actor – ICC and MNC – stealthily helped develop a complete system of language straddling on law, tax, accounting, trade, investment and diplomacy from the spell of which neither the developing state nor the neo-Marxist theoretician could ever really come out. There has always been going on a meekly debate as to what to include in PE and what to exclude from it, but the real issue of its very existence was never allowed to be on the table as agenda item. Bachrach et al suggest including the confining of 'the scope of decision-making to relatively "safe" issues', into the concept of power and its exercise, and that being logical and rational, the dominant actor would attempt to keep the real important issues off the agenda.[149]

Even at UN, the developing countries squabbled and fought for fringes and never for the core. The very title 'Double Taxation Agreement' has an Orwellian tinge about it – it never was

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[145] Article 7, Paragraph 1 of *OECD Draft Model Taxation Conveion on Income and on Capital 1963, supra* note 122.

[146] *Ibid.*, art. 7, para. 2.

[147] Article 7 Paragraph 1 of *United Nations Model Double Taxation Convention 1980, supra* note 133.

[148] P. Pistone, 'Tax Treaties with Developing Countries: A Plea for New Allocation Rules and a Combined Legal and Economic Approach', in Michael Lang (ed.), *Tax Treaties: Building Bridges between Law and Economics* (Amsterdam: IBFD, 2010), at 413.

[149] Peter Bachrach and Morton Baratz, 'Two Faces of Power', *The American Political Science Review*, 1962, 56(4):947-52, at 950.

about double taxation; it always was about taxation rights on international business operations and coercing weaker partners in the equation into accepting the terms and conditions that were not defendable on the canons of law, justice, and fair play. In fact, the very insertion and routing of the PE ploy through UN MTC – supposedly a multilateral institution in which all states represented themselves on an equal footing – provided a default position for developing countries as if it was favorable and most suited to them. The UN MTC extends the semantic trap stipulating that 'principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons'.[150] This manifestly amounted to distractionary agenda-resetting since elimination of double taxation was only one article and that too in the wake of unilateral relief, which most tax systems allowed, had lost its near-complete luster. This is also evident from the fact that hardly ever an MNC approached a tax administration for a tax relief problem; it was almost always on account of taxability in the source state.

The conditioning of developing countries has reached such a level that signing of a DTC is celebrated as an event of national import and an achievement by sitting governments without realizing their implications for future generations. This is simply because there is not even an iota of evidence to suggest that a DTC has a direct relationship with FDI and increase in trade volumes, but there is a complete consensus as to their being instrumental towards base erosion and profit shifting.[151] Thus, most DTCs that developing countries ended up signing over the past hundred years constitute vanity agreementization of the state as these easily outlive the incumbent signing governments.[152] The oppressive implications of hierarchically-oriented lopsided international taxes regime do not end here; those actually manifest and galvanize at the DTC negotiating table where ill-trained experts from developing countries and high-end professionals from developed countries unequally engage for uneven predictable outcomes. Probably; nay, almost certainly, had UN not stepped into the fiscal domain and come up with its MTC, which essentially is the mirror image of OECD MTC, it would have done a lot of good to the developing countries. In fact, the developed world by pitching up UN MTC as 'counter' to the OECD MTC practically monopolized the entire epistemological space for any independent alternative thinking by developing countries. With this dimension of the matter in view, one is not sure of any benefits accrued to, but one is more likely to be certain of the harm UN MTC caused to developing countries.[153]

6.4. BEPSization of PE

Once PE was over with early hurdles, it ruled the roost with all its caveats, exceptions, and refinements almost unhinderedly until the launch of the OECD's BEPS initiative in 2013. The

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[150] *United Nations Model Double Taxation Convention between Developed and Developing Countries 2017*, *supra* note 1, at 70.
[151] McGuaran 2013, *supra* note 125.
[152] 'Vanity agreementization' implies that one has to vainly sign an agreement just because others are signing it, and in many a situation, in the context of developing countries, DTCs are signed merely for political reasons, that is, since a high dignitary is visiting another state, there ought to be a signing ceremony of some inter-nation protocol, convention or agreement for media projection, domestically.
[153] Muhammad Ashfaq Ahmed, 'U.N M.T.C Article 6: The Predatory Ploy - the Spectre of Privileged Player in a Rigged Game', *Intertax*, 2020, 48(10).

study discounts the proposition that PE is diluting in efficiency and relevance due to digitalization of international economic and business practices. It is argued that BEPS was only a manifestation of pre-existing reality that had started to dawn early in history, but its public cognition was resisted until, of course, capitalist state itself fell prey to it. Jogarangan asserts that 'possibility of profit-shifting and double non-taxation had already been recognized by the 1925 Experts almost 90 years ago', and that these problems were 'not a consequence of the digital economy'.[154] The OECD itself has admitted that 'digital economy and its business models do not generate unique BEPS' risks though 'some of its key features' might 'exacerbate' pre-existing ones.[155] On the contrary, it is posited that BEPS, in fact, sprang from internal inherent flaws and fissures of capitalism, but there are other contributory factors that appear to have been at work, too. It has been argued that the extant international taxes framework 'favors developed countries and reduces the scope of developing countries' taxation powers', and 'reviewing the balance between these two groups is not the scope of the BEPS Project or any other international initiative'.[156]

The point being hammered home is that it is not because of digitalization of economy that PE principle has fast diluted but because of the MNC having grown out of its size and its threatening overtures to capitalist state. Thus, the most important proposal floated under the BEPS initiative is perhaps not with regard to Action 6,[157] which directly deals with the misuse of PE status, but under Action 1 that exhibits a mild shift from physical presence towards economic presence – slowly but compulsively.[158] It has pertinently been remarked that digital MNC's 'global profits are a global tax base for all countries that contribute to these profits', but 'many countries do not get their due share of global taxes', as the 'tax base is not fairly apportioned/ distributed amongst different countries'.[159] At some level, this shift needs to be seen within the framework of dialectical idealism, and pulsates of history.

7. CONCLUSION

Thus, to summarize, the much-touted 'double taxation' on which the entire superstructure of international taxes consisting of MTCs and a network of bilateral DTCs was erected was the decoy behind which the real issues like inter-nation allocation of taxing rights, tax evasion, tax havens, an all-encompassing EOI, and capital flight were selectively promoted. The PE, from this angle, could be equated with an iceberg – the invisible part being far bigger than the visible one. The developed world continued to be dismissive and in denial mode to the issues like capital flight, tax evasion, and EOI until, of course, those started to trouble the developed world

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154 Jogaranjan 2018, *supra* note 40.

155 OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (Paris: OECD Publishing, 2015), at 12.

156 Sergio Andre Rocha, 'The Other Side of BEPS: "Imperial Taxation" and "International Tax Imperialism" in Countries', in Sergio Andre Rocha and Allison Christians (eds.), *Tax Sovereignty in the BEPS Era* (Wolters Kluwer, 2017).

157 BEPS Action 6 is entitled 'Preventing the Granting of Treaty Benefits in Inappropriate Circumstances'.

158 BEPS Action 1 is entitled 'Addressing the Tax Challenges of the Digital Economy'.

159 Rashmin Sanghvi, Naresh Ajwani, and Rutvik Sanghvi, 'Tax War on International Taxation for Digitalised Economy', in The Chamber of Tax Consultants, *Compendium on International Taxation* (Bombay: Rashmin Sanghvi & Associates, 2019).

itself. The built-in pro-developed country bias in the extant international taxes framework is deep-rooted and historically embedded. Jogaranjan with reference to EOI under LN MTCs pertinently remarked that ‘it was thought to be completely unacceptable that residence-countries would provide information regarding their residents to enable them to be taxed in another (the source) country’;[160] and this dismissiveness was not confined to EOI only. The historic building blocks like LN Report 1923, LN Report 1925, LN Report 1927, LN MTC 1935, and LN MTC 1943, and LN MTC 1946, supply the international taxes system in general, and the PE principle, in particular, a steel-frame of some strength, which the developing countries really found hard to make a dent into; cognition of the muffled reality was in short supply, too. This is also explainable in terms of the fact that the entire process of development of MTCs was effectively monopolized and controlled by developed country experts – barring of course, LN MTC 1943. The UN MTC also virtually shrank in near-entirety the epistemological space for developing countries to think outside the given paradigm. Their helplessness was reinforced by Neo-Marxists’ utter failure to identify capitalism’s super-survivalist ploys in their true essence.

The appraisal of PE by juxtapositioning it inside the ideological pulls of capitalism and communism not only seminally contributes to pre-existing knowledge pool on the subject, but it also expands its frontiers. The key capitalist outmaneuvers – PE and MNC – sponsored and promoted by capitalist state – did well by predating on the peripheral nations and providing succor to capitalist mode of production for good about hundred years until, of course, those started to predate back on capitalist state itself, and to shift funds to tax havens, instead. Given the pace of globalization that is likely to further fuel cross-border trade of goods and services and flows of capital in the times to come potentially unsignifying international geo-physical boundaries, and having seeped into the very language of international fiscal diplomacy, PE is going to stay for a time – until, of course, it completely steams out, and is forsaken having been out-invented by newer and more effective tools of economic excesses, exploitation and domination of the developing by the developed world. This is despite the fact that the PE is visibly exhibiting signs of weakening and dilution, but it is plausibly not due to digitalization of international economy as is generally believed, but due to capitalist state’s fatigue with the MNC and its excesses, and the tax haven problem.

The PE’s success lay in complete elimination of its alternatives by the capitalists as semantic spectrum was controlled completely. Their triumph in carrying the predatory tool of PE going, for a century, is also to be seen in terms of their ability to ‘internationalize’ it full well and have it tethered to and baptized by multilateral forums like LN, and UN. The people manning these organizations were comprehensively conditioned and coopted. The debate was always successfully steered within that narrow range of what to include in or exclude from PE, but was never allowed to question the very existence, legitimacy and validity of PE itself. The journey of evolution of PE from what it was conceived as, and due to, and what eventually it has evolved into, there is a sea difference. In the Prussian context, it was conceived as a tool to ensure fair revenue contribution to source states; a century and a half since it has grown into to

[160] Jogaranjan 2018, *supra* note 40.

ensure exactly the opposite, and a brute protection ploy of MNC and capitalist state's interests, and the preservation of capitalism. The UN's role has been thoroughly dubious as while unfunded mandates to ensure good governance, reduce poverty, improve health, increase literacy rates and ensure sustainable development of their peoples were assigned to developing countries, it practically turned a blind eye rather lent support to a sustained erosion of their own legitimate tax base. It is, therefore, that the 'close link between taxing powers and the ability of the state to fulfill its obligations to its citizens', is asserted, and states vociferously 'articulate sovereignty as a defense to certain international tax overtures';[161] not in case of 20th century developing countries, though. It may be because UN was infiltrated into, duped or maybe that is how it was planned to pan out, but the fact remains that UN's pandering has done more harm than good to the cause of the developing world in the larger developmental context. The European heartland – a quarter to two centuries down the line – is re-living Prussia – trying to frame rules to ensure taxation in the source state; history has run full circle.

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[161] Diane Ring, 'What's at Stake in the Sovereignty Debate?: International Tax and the Nation-State', *Virginia Journal of Int'l Law*, 2008, 49(1) .