

THE CREATION OF A PERMANENT ESTABLISHMENT ABROAD

INTRODUCTION

The definition of a multinational enterprise (MNE) indicates a company that carries out its activities abroad in several countries, which are linked and can operate in numerous ways. More specifically, «A multinational enterprise, abbreviated as MNE [...] is an enterprise producing goods or delivering services in more than one country. »¹ This concept is important to understand the contemporary global economic context, where national borders are increasingly permeable, and economic activities are expanding on an international scale. According to the OECD, MNEs are central elements in the global economy, capable of influencing and shaping the fiscal policies and legal regulations of States².

In a progressively globalized economy, investing more or less permanently in one or more foreign countries has now become an unavoidable strategic need for many companies that decide to operate in sectors of international value, dealing with significant legal and fiscal challenges as they expand their operations across borders. Specifically, when we talk about multinationals, we implicitly deal with a problem that is common to all companies that decide to operate abroad: determining the appropriate legal structure, which brings significant consequences, particularly at the tax level. The concept of Permanent Establishment (PE) is the main notion in international taxation that determines the tax obligation of a foreign entity in a host country. The permanent establishment is defined by Article 5 of the OECD MC as «a fixed place of business through which the business of an enterprise is wholly or partly carried on»³⁻⁴. The definition of PE, although universally recognized, has attracted different interpretations based on local legal and tax contexts⁵.

¹ Glossary: Multinational enterprise (MNE) - Eurostat

² OECD (2015). OECD/G20 Base Erosion and Profit Shifting Project. OECD Publishing.

³ art.5 OECD (2019), Model Tax Convention on Income and on Capital 2017 (Full Version), OECD Publishing, Paris, <https://doi.org/10.1787/g2g972ee-en>.

⁴ Van Raad, K. (1983). Model Income Tax Treaties. In: van Raad, K. (eds) Model Income Tax Treaties. Springer, Dordrecht. https://doi.org/10.1007/978-94-017-4438-6_1

⁵ Vogel, K.,(1997) Double Taxation Conventions. Springer.

MNEs have been involved for several years in a process of international integration, favored by the growing presence of foreign commercial partners and by the intention to take advantage of the opportunities offered by global markets. These conditions are also favored by the so-called «globalization», which has been talked about for some time now as a phenomenon that characterizes our historical period, and of which the dynamic evolution of the markets is only one of the aspects.⁶ Globalization has led to a growing interest among companies in the benefits of locating operations in countries with tax advantages but has also introduced complexities in terms of international tax compliance.⁷ When companies try to optimize their international presence, ensuring conformity with local and international tax regulations, they need to understand and effectively manage PE risks. Governments have intensified their control over corporate structures, given the rapid evolution of global business models, to prevent artificial avoidance of PE status, and as a result, MNEs need to carefully evaluate their international activities to mitigate tax risks, optimize tax efficiency, and ensure legal compliance.⁸

According to this position, the main goal of this work is to offer an analysis of the development of the idea of permanent establishment, a definition that has experienced significant change over the past ten years in an effort to better meet the demands of new, globally integrated business models. In order to investigate the legal and tax implications of establishing a permanent establishment abroad, this study compares France and Italy, two important European countries with distinct but comparable approaches to PE regulation. In particular, this study will examine the various definitions of PE and the related tax and compliance obligations under national laws, international treaties, and the OECD Model Tax Convention.

This research will offer useful insights into the decision-making process behind entering foreign markets by examining the possible benefits and disadvantages of operating through

⁶ «Globalization» indicates the growing interdependence between countries in many respects, not only in economic terms, but also political and social. Geographical space is shrinking, thanks to the high speed of means of communication, information flows and means of transportation. – Cfr J. Baylis – S. Smith, *The Globalization of World Politics. An Introduction to International Relations*, Oxford University Press, 1997.

⁷ Avi-Yonah, R. S., (2007), *International Tax as International Law*. Cambridge University Press.

⁸ Organisation For Economic Co-Operation And Development. Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7, 2015 Final Report. Paris, OECD Publishing, 2015.

a branch or a subsidiary and particularly dealing with the differences in the legal tax framework between France and Italy.

A decisive part of this study is a case analysis of San Marco Group S.p.A., an Italian company in the paint and coatings industry, which recently expanded into France. The case study will look at the company's strategic choices in the French market regarding risk assessment, tax optimization, and legal structuring. To achieve these objectives, this thesis will be structured as follows:

The first Chapter defines the theoretical framework of permanent establishment, outlining its historical evolution and examining the role of international tax treaties, with particular attention to the OECD Model Convention and the challenges posed by double taxation and anti-avoidance measures.

The second Chapter compares the two main modes of establishing a presence abroad, the branch and the autonomous subsidiary, focusing on their legal, accounting, and fiscal aspects, and assessing how recent developments, such as the BEPS Project, have influenced profit allocation strategies.

The legal and tax structures for permanent establishment in France and Italy are examined in the third chapter. It provides a comparison of the standards applied in the two jurisdictions, the differences in how the digital economy and anti-abuse laws are implemented, and the tax impact.

The fourth and final Chapter applies the theoretical insights to the case study of San Marco Group, analyzing its internationalization strategy in France, the potential tax risks related to permanent establishment, and the compliance obligations arising from cross-border operations.

The motivation for undertaking this research arises from my professional experience in San Marco Group S.p.A. Working within this organization has provided me the opportunity to see closely all the processes of thinking and analysis associated with legal and tax challenges. By offering an organized and comparative academic perspective on Permanent Establishment

laws, this analysis aims to assist the business by facilitating well-informed decision-making and improving the evaluation of upcoming global strategies.

At the same time, the direct experience gained within San Marco Group represents a significant added value for the thesis itself: It makes the research more tangible and practically applicable by enabling the theoretical framework to be connected to an observed case. Thus, the relationship between the two dimensions, academic research and professional practice, is simultaneously reinforcing: the thesis provides the company with more comprehensive analytical tools, and the company's direct experience guarantees that the research stays relevant to the actual challenges experienced by multinational corporations during their international expansion.

METHODOLOGIES

This work employs a qualitative and applied approach, integrating theoretical foundations, comparative legal review, and case study analysis to evaluate the legal and tax implications of creating a Permanent Establishment abroad.

The methodology consists of four main components:

The study begins with an in-depth review of legal sources, academic literature, and international tax frameworks, focusing on the OECD Model Tax Convention, particularly Article 5, which defines PE criteria and the Base Erosion and Profit Shifting (BEPS) initiative, which introduces measures to prevent the artificial avoidance of PE status. This review will provide the theoretical foundation for understanding how PE is defined, interpreted, and regulated in international taxation.

The study continues with a comparative analysis of business structuring that involves examining the two main forms of foreign organization branches and subsidiaries from a legal, fiscal and operational perspective. This analysis aims to assess the advantages, risks, and tax consequences of each structure, helping to contextualize PE risks in international business expansion.

Moreover, the study conducts a comparative examination of PE regulations in France and Italy, assessing their implications for multinational enterprises. The analysis will focus on: Legal definitions and regulatory requirements for PE in each jurisdiction, taxation frameworks, including corporate tax rates, profit allocation rules, and the impact of double taxation treaties and alternative corporate structuring options, comparing the use of branches vs. subsidiaries in mitigating tax exposure and compliance.

To demonstrate the application of the theoretical and comparative legal insights developed in the preceding chapters, a practical case study of San Marco Group S.p.A. will be conducted as the thesis's final section. The case study will examine San Marco Group's activities in France to: (1) determine whether the autonomous subsidiary could be considered a taxable PE under OECD and national tax laws, considering its operational and managerial autonomy;

(2) assess associated tax burdens, profit allocation, and compliance risks; and (3) identify strategies to minimize PE exposure while ensuring tax efficiency and regulatory compliance.

By integrating academic research, comparative legal analysis, and real-world corporate data, this study aims to provide a comprehensive examination of PE risks and structuring strategies, offering actionable recommendations for multinational enterprises pursuing international expansion.

Chapter 1. The Notion of Permanent Establishment in International Tax Law

1.1 Premise

Addressing tax law compliance, there are three main approaches in which MNEs can cross borders:

- by establishing a parent-subsidary structure that is a foreign subsidiary from which the whole company serves overseas markets.
- by conducting short-term cross-border activities without, or unrelated to, a fixed or persistent establishment in the destination state

Or

- By creating branches, offices, factories, shops or other facilities that are not incorporated but remain part of the national legal entity, a Permanent Establishment must exist for tax purposes⁹.

Among the three ways MNEs can engage in international activities, this chapter will specifically address the third one: the creation of a PE.

The concept of permanent establishment is universally accepted as a prerequisite for the taxation of an economic activity carried out in a given country by a foreigner¹⁰ and is the legal institution that allows a contracting State to exercise its taxing power on the profits generated by a company resident in another contracting State, operating as a true criterion of connection between the income produced and the tax jurisdiction of the same State to subject it to taxation.

⁹ Reimer, Ekkehart, et al., (2018), Permanent Establishments. Kluwer Law International B.V., 7.

¹⁰ Lovisolò A., (1983), Il concetto di stabile organizzazione nel regime convenzionale contro la doppia imposizione, in *Dir.Prat.Trib.*, p. 1127 - «[...] universalmente accolto come presupposto per l'imposizione di un'attività economica svolta, in un dato Paese da uno straniero»

Dealing with the interpretation and application of double tax treaties, the Commentary to the OECD Model Convention is essential¹¹⁻¹². Although it does not have binding legal force, the Commentary is an authoritative interpretative tool, widely recognized and used internationally. It is drafted by the OECD Committee on Fiscal Affairs, composed of experts appointed by the governments of the Member States and it leads each article of the OECD Model by providing clarifications, explanations and practical guidance on the application of the relevant provisions¹³.

The adoption of the OECD Model as a basis for the conclusion of bilateral conventions has meant that the Commentary has been considered, in international practice, as a fundamental reference guide for the consistent interpretation of conventional rules.

Analyzing the Commentary therefore allows not only to understand the original intent of the international legislator, but also to orient oneself in the complex explicative activity that emerges from the concrete application of tax treaties. Precisely for this reason, the in-depth analysis of the Commentary constitutes the necessary starting point for a systematic and effective analysis of conventional law in tax matters¹⁴.

1.2 Historical Evolution of the PE Concept

1.2.1 Origins and early applications of Permanent Establishment

In the second half of the 19th century, Europe was undergoing intense economic and political changes where industrialization advanced, markets expanded beyond national borders, and modern state structures consolidated. This historical period saw the birth of an increasingly dynamic and mobile capitalism, with companies capable of operating in multiple territories without necessarily having fixed headquarters everywhere. At the same time, the creation of nation-states made fiscal authority stronger, increasing the need for clear legal rules to decide which country could tax business income earned within its borders¹⁵.

¹¹ OECD (2019), Model Tax Convention on Income and on Capital 2017 (Full Version), OECD Publishing, Paris, <https://doi.org/10.1787/g2g972ee-en>.

¹² OECD (2019), Model Tax Convention on Income and on Capital 2017 (Full Version), OECD Publishing, Paris, <https://doi.org/10.1787/g2g972ee-en>.

¹³ Transfer pricing and multinational enterprises : report of the OECD Committee on Fiscal Affairs, 1979. Organisation for Economic Co-operation and Development ; sold by OECD Publications Center].

¹⁴ Hentschel S. (2021), The Taxation of Permanent Establishments.

¹⁵ Bonney, R., (1999), (ed.), 'The Rise of the Fiscal State in Europe, c. 1200–1815