Permanent Establishment

Permanent Establishments or *PE* is an international tax concept whereby a jurisdiction can directly tax a company based on whether or not the activities of the company are deemed to have enough presence to be considered "doing business" in that jurisdiction. A US State equivalent of PE is the concept of Nexus (whereby States will attach to a company's earnings and transactions in an effort to further locally tax them). When a company performing business activities that trigger PE in a jurisdiction, this translates into that particular jurisdiction having the ability to levy and assess taxes on the company's income and transactions, requiring registration and continuing compliance.

What causes PE (when is a company considered to be doing business in a jurisdiction)? In most cases, the activities or presence giving rise to a PE are defined in the bi-lateral treaty between the two countries. Article 5 of most treaties outlines allowable activities that can be performed without the implication of a company being deemed to have a PE (refer to the general chart below). Though the overall rules are identified caution should be noted specific to those countries that do not have a treaty that could conceivably cause *any* activity giving rise to a PE.

A full facts-and-circumstances understanding should be obtained to determine whether there is the possibility of a PE. If there is a PE, implications arise not only to the nonresident company but could as well to the individual(s) involved in giving rise to the PE i.e. personal taxation in the host country. The determination of a PE is just the beginning. If a PE exists consider the next hurdle to clear – a) how will the PE be compensated and structured, should transfer pricing regulations apply; b) the type of business form virtually created by the PE; c) reviewing international travel and relocation of domestic and foreign personnel (including numbers of employees, duration of temporary assignments, and other aspects of expatriate assignments); and c) local statutory and regulatory compliance will be requirements; both company level and individual level.

There is a myriad of matters to consider when business activities cross-border, and PE is certainly one of those concerns. Executed with full knowledge, foreign direct investment can be a strategic planning tool impacting effective tax rates, import/export process, and better managing exposures.

Quick view, Article V (Most Treaties)

Avoids PE (Do's)	Generates PE (Don'ts)
Places of Business	
• Use facilities solely for storage, display, or delivery;	• Maintain a place of management, branch, office, factory, or workshop
• Maintain stock solely for storage, display, or delivery;	• This may include on-site locations at a customers facility
• Maintain a fixed place of business solely for purchasing goods or collecting information;	
• Maintain a fixed place of business for preparatory or auxiliary functions;	
• Maintain a fixed place of business for any combination of the above.	
Personnel	
• Engage brokers, general commission agents, other independent agents;	• Have personnel habitually acting on behalf of the Company (**which may include independent agents**);
• Allow personnel (independent or not) to perform promotional market research activities;	• Conclude on contracts on behalf of the Company
• Allow personnel to maintain accounts on behalf of the Company;	• Effect the transfer of goods on behalf of the Company;
• Effect any sale through an independent contractor or agent;	• Issue invoice;
• Open/receive letters of credit;	
• Receive payment against any invoices;	

Country Exhibit:

US/Canada

U.S. Internal Revenue Service (IRS) and Department of Treasury officials expressed call to increase focus of U.S. enforcement activity and audit scrutiny on permanent establishment issues. Effective changes enacted by the Fifth Protocol to the Canada-U.S. Tax Treaty expand the circumstances in which a Canadian corporation can be deemed to have a U.S. permanent establishment. Permanent establishment issues can be particularly worrisome to North American corporations operating in both Canada and the United States, where efficient operational decision-making often requires cross-border reporting and divisional integration. Canadian and other non-U.S. corporations operating in the United States should be sensitized to the potential increase in U.S. permanent establishment audit activity, while companies operating in the United States and Canada should also consider the implications of the expanded definition of permanent establishment enacted by the Fifth Protocol.

Under the Canada-U.S. Treaty, and also the U.S. and OECD Model treaties, a corporation resident in Canada may be taxable in the United States only where its activities in the United States give rise to a permanent establishment. A permanent establishment is generally defined to include either a fixed place of business (e.g., an office, branch, place of management, factory, etc.) or a dependent agent who habitually exercises the authority to conclude contracts on behalf of the corporation in the United States. Furthermore, at January 1, 2010, the Canada-U.S. Treaty provides that a Canadian corporation may be deemed to have a U.S. permanent establishment if it either (a) performs services in the United States through an individual present in the United States for an aggregate of 183 days or more in any given twelve-month period and certain other conditions are met, or (b) provides services in the United States for an aggregate of 183 days or more in any given twelve-month period with respect to the same or connected project for U.S. customers. If a Canadian corporation has or is deemed to have a permanent establishment in the United States, the Canadian corporation will be subject to U.S. tax return filing obligations and will be required to pay U.S. tax on business profits attributable to that permanent establishment. If profits of a permanent establishment that are taxed by the United States are also taxed in Canada and foreign tax credits are unavailable to offset the full amount of the U.S. tax payable, double taxation on the U.S. source income of the Canadian resident may result. Moreover, if a Canadian corporation fails to file a U.S. tax return because it believes its U.S. activities do not constitute a permanent establishment, that Canadian corporation (if it is later found to have had a U.S. permanent establishment during taxable periods for which a U.S. return was not filed) may be denied the ability to subsequently claim any deductions against income attributed to its U.S. permanent establishment.

For North American businesses with integrated operations, segregating activities between Canadian and U.S. employees and affiliates in an attempt to avoid creating a U.S. permanent establishment can be cumbersome in order to operate in a cross-border capacity. Caution should be given on efforts to rely on “dotted-line” operational reporting between U.S. and Canadian employees participating in an integrated business function to segregate taxability;

this may be weakened by inconsistent factual operating patterns. Some U.S. case law and OECD commentary provide support for the proposition that a Canadian corporation consistently looking to guidance from a U.S. manager might be regarded as having a permanent establishment in the United States, even if its contracts are formally concluded outside the United States.

While U.S. government officials' statements were coupled with the reassurance that the United States remains committed to a high permanent establishment threshold, the above example nonetheless suggest that the United States may look to advance these and other arguments on audit in an attempt to more aggressively assert that Canadian corporations have U.S. permanent establishments and should be subject to U.S. tax.