Permanent Establishment
Presented by
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- **Introduction**
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  - Dependent Agency PE
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Permanent Establishment - Introduction

- Permanent Establishment (“PE”) risks are a fact of life, for all multinationals
- PE concepts have been changing and will continue to change
- PE risks are not just academic: Given budget deficits globally, practical use of PE in order to tax multinationals will increase
- PE’s can also create work permit, social security, withholding tax and personal income tax issues, not *just* corporate income tax issues
- Consistency in documenting a business transaction is key to lower risks of re-assessment
- Everyone has a role to play to mitigate the risk

Permanent Establishment: What is it?

A tax concept to allow taxation of a foreign entity by deeming that a taxable presence (nexus) exists in that country

Country One

Seller

Normally, wants to avoid a PE

Country Two

Distribution, services

Purchaser/Distributor

Might be same entity or an affiliate

PE

Normally, will have a PE

Applicable treaty is a key instrument in avoiding double taxation

- Is there a PE?
- How much profit should the PE make? IRC Section 482 and similar statutes in other countries.
- Also consider local law, either in the absence of a treaty or in conjunction with a treaty.
- Consider state and local laws.

Permanent Establishment
Three Types of PE

1) Fixed place PE: *"… a **fixed** place of business through which the business of an enterprise is wholly or partly carried on." Article 5 of both Model Treaties*

Includes: office, workshop, place of management, branch, factory

Excludes:

i) Holding stock for solely storage, display, delivery, processing, purchasing and,

ii) Fixed place solely for **preparatory** or **auxiliary** activities

*"**Preparatory or Auxiliary**"* exception is a question of facts rather than principles: monitoring the performance of contracts can be auxiliary and preparatory

Means not essential and significant part of the activity of the enterprise as a whole:
e.g.: ***solely purchasing for*** is normally excluded in double tax treaties

Permanent Establishment
Three Types of PE (cont'd)

- **2) Dependent Agency PE**: ***Dependent*** *agent* ***authorized*** *to* ***conclude contracts*** *in a country on behalf of an entity in another country and uses, in fact or in law, that authority* ***regularly***
  - Facts decide: A person must have the **authority** to **conclude contracts** on **behalf of** another person and must **regularly exercise** that **authority** (irrelevant whether or not there is a formal delegation of power to represent as long as a person acts for another)
  - Reference: Paragraph 5 of Article 5 of both Model Treaties

Permanent Establishment
Three Types of PE (cont'd)

- **3) Installation PE*:* if project continues for more than twelve months – Both Model Treaties Article 5, Paragraph 3**

- ***Examples:*** *Building site, installation project, drilling rig, etc.*

- ***Caveat:*** *Some treaties set different time limits.*

- ***Examples:*** *US/Mexico Treaty provides for 6 months – Article 5, Paragraph 3; US/Canada allows 12 months for installation, but 3 months in any twelve-month period for a drilling rig. Article V, Paragraph 4.*

- ***Without a treaty the PE could exist from day 1.***

PE in the Bilateral Treaty Context

- Double tax treaties **override** domestic law (generally).

- The goal of a treaty is to avoid double taxation and prevent tax evasion.

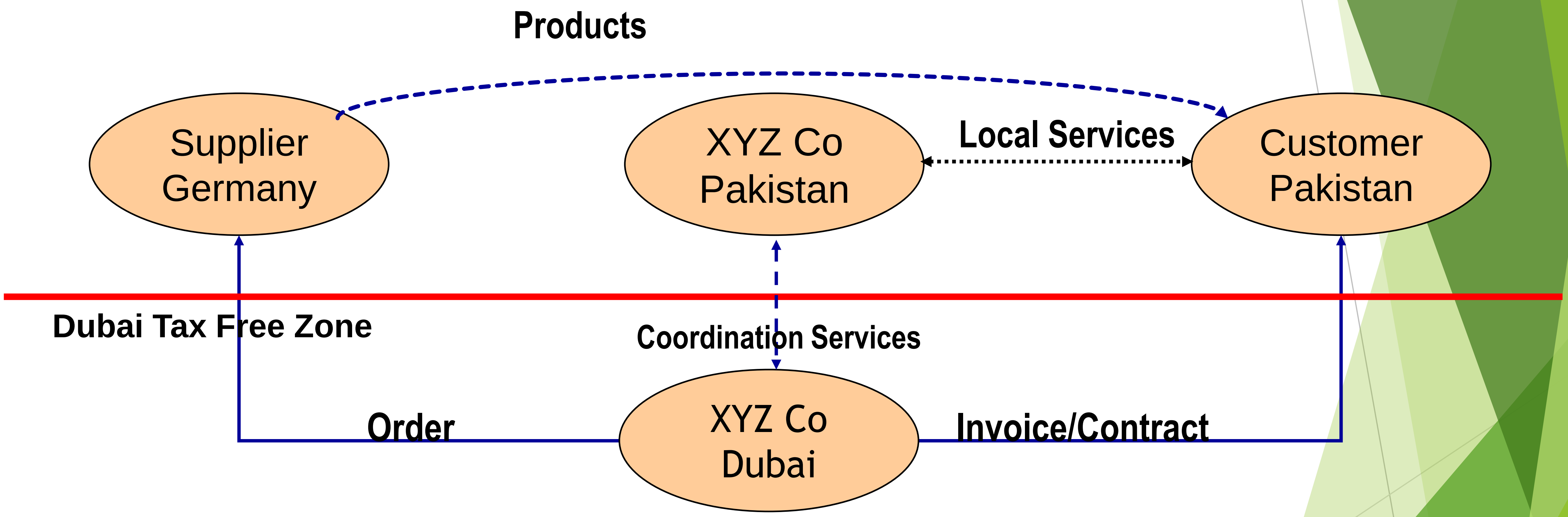
- A treaty has a mechanism to avoid double taxation through a mutual agreement procedure. This can be lengthy and costly with no ultimate guaranteed result.

- Tax treaties generally only deal with income taxes (not indirect taxes or state taxes).

Impact of local legislation

- Domestic PE definitions can vary widely and are not always based on OECD PE concepts: example - Brazil
- Definition of PE can be different for corporate income tax, VAT and local tax purposes.
- The definition of PE in the OECD model treaty is typical (Article 5).
- In the US, in the absence of a treaty, the applicable rules are set out in IRC Section 861 et seq.
- Other countries have rules that apply in the absence of a treaty.

Trade Flow Example



Practical Potential for a PE

- Sales abroad
- Warehouses abroad
- Sourcing abroad
- Large installation projects abroad

Indirect Indication of a PE
Common Issues

- Business cards of individuals indicating a position in a foreign company, or specifying an address, e-mail address or telephone number in another country.
- Templates of business correspondence of a foreign company may contain contact information of foreign presence (address, phone, fax etc).
- Business correspondence in the name of foreign company may be found to be carried on from e-mails in another country.

Summary Do's/Don'ts

Host Country DO's	Host Country DON'TS
Introducing products	Conclude ForCo sales
Advise on price/delivery/payment terms within a range set by ForCo	Negotiate price/delivery/payment terms with ForCo customers
Follow guidelines from ForCo and when unclear request guidance	Exercise discretion where instructions provided by ForCo are unclear
Act as a liaison person between customers and ForCo	Have an identifiable ForCo permanent place of business
Actively remind ForCo customers of outstanding accounts receivable	Identify yourself as a ForCo employee
Advise customers that local Host Country employees cannot commit ForCo contractually	Hold yourself out as being agents or representatives of ForCo
Refer discussions with customers regarding settling a receivable at less than full value to ForCo	Settle ForCo receivables at less than full value

Questions?

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