

IFA (Canadian Branch)  
2010 Travelling Lectureship Program

THE DEFINITION OF PERMANENT  
ESTABLISHMENT: ERODING OR  
EVOLVING?

Jacques Sasseville  
Brian J. Arnold

---

---

---

---

---

---

---

---

THE DEFINITION OF PERMANENT  
ESTABLISHMENT: ERODING OR  
EVOLVING?

Jacques Sasseville  
Centre for Tax Policy and Administration,  
OECD  
Brian J. Arnold  
Professor of Tax Law Emeritus; Tax Consultant

---

---

---

---

---

---

---

---

Outline

- 1) Function of the PE concept
- 2) Basic elements of the definition of a PE
  - Fixed place of business
  - Dependent agents
- 3) Controversial aspects of the definition of a PE
- 4) Services PEs

2

---

---

---

---

---

---

---

---

### Function of the PE Requirement

- Establishes a threshold for source state taxation of business profits under Art. 7
- Domestic law functions?
- Allocation of tax revenues on business profits between residence and source countries

3

---

---

---

---

---

---

---

---

### Function of the PE Requirement

**Other treaty functions of a PE:**

- Dividends, interest, and other income effectively connected with PE — Art. 10, 11, and 21
- Capital gains from property of a PE — Art. 13
- Remuneration of employees borne by PE — Art. 15
- Nondiscrimination — Art. 24(3)

4

---

---

---

---

---

---

---

---

### The PE as a Threshold for Taxation

- Compare threshold under domestic law for taxation of business profits of nonresidents: carrying on business in Canada
- Many countries use PE for domestic law
- Compare other treaty thresholds

5

---

---

---

---

---

---

---

---

**Threshold Requirements in the OECD Model**

1) Business profits:

- a) General: Article 5
  - PE — fixed place of business
  - agency PEs
  - exception for preparatory activities
- b) Shipping and air transportation: Article 8
  - no source country tax
- c) Entertainers: Article 17
  - activities in source country
- d) Real property: Article 6
  - property located in source country

6

---

---

---

---

---

---

---

---

**Threshold Requirements in the OECD Model**

2) Employment

- a) General: Article 15
  - duties performed in source country
  - exception based on nonresident payer and 183-day threshold
- b) Directors' fees: Article 16
  - where corporation is resident
- c) Government service
  - services rendered in source country by resident and citizen of source country

7

---

---

---

---

---

---

---

---

**Threshold Requirements in the OECD Model**

3) Investment income

- a) Dividends and interest: Articles 10 and 11
  - payer resident in source country
  - PE rule
- b) Royalties: Article 12
  - no source country tax
  - for some countries, same as dividends and interest
- c) Capital gains: Article 13
  - where property located for real property and business assets of a PE
  - other property, no source country tax

8

---

---

---

---

---

---

---

---

### Threshold Requirements in the OECD Model

- 4) Students: Article 20
  - no source country tax on payments from outside for education
- 5) Other income: Article 21
  - no source country tax
  - exception if PE

9

---

---

---

---

---

---

---

---

### Threshold Requirements for Other Taxes

- Uses of the PE threshold for VAT / GST / other taxes
- EU VAT Directive (2010)
- United States Sales and Use Taxes: the "Amazon law"
  - Nexus rules for Sales and Use Taxes
  - California Senate's approval of ABX8 8 on 18 February 2010

10

---

---

---

---

---

---

---

---

### EU VAT Directive (2010)

*Article 44*

The place of supply of services to a taxable person acting as such shall be the place where that person has established his business. However, if those services are provided to a fixed establishment of the taxable person located in a place other than the place where he has established his business, the place of supply of those services shall be the place where that fixed establishment is located.

11

---

---

---

---

---

---

---

---

### EU VAT Directive (2010)

*Article 45*

The place of supply of services to a non-taxable person shall be the place where the supplier has established his business. However, if those services are provided from a fixed establishment of the supplier located in a place other than the place where he has established his business, the place of supply of those services shall be the place where that fixed establishment is located.

12

---

---

---

---

---

---

---

---

### EU VAT Directive (2010)

*Article 46*

The place of supply of services rendered to a non-taxable person by an intermediary acting in the name and on behalf of another person shall be the place where the underlying transaction is supplied in accordance with this Directive.

13

---

---

---

---

---

---

---

---

### California's ABX8 8

"Retailer engaged in business in this state" [...] means and includes any of the following: [...]

(5) (A) Any retailer entering into an agreement or agreements under which a person or persons in this state, for a commission or other consideration, directly or indirectly refers potential purchasers of tangible personal property to the retailer, whether by a link or an Internet Web site or otherwise, [...]

14

---

---

---

---

---

---

---

---

### California's ABX8 8 (cont.)

*provided that the total cumulative sales price from all of the retailer's sales of tangible personal property to purchasers in this state that are referred pursuant to all of those agreements with a person or persons in this state, within the preceding 12 months, is in excess of ten thousand dollars (\$10,000).*

15

---

---

---

---

---

---

---

---

### Fundamental Policy Questions

- Does PE requirement make sense?
- What alternative threshold requirements could be used?
  - Income or gross income
  - Length of physical presence
  - Activities test
- Should same threshold be used for all types of businesses?

16

---

---

---

---

---

---

---

---

### Fundamental Policy Questions

- Canada has interests as source country and residence country
- Interests vary *vis-à-vis* each treaty partner
- PE rules are relatively uniform
- Special rules for developing countries

17

---

---

---

---

---

---

---

---

**Overview of Article 5**

- Art. 5(1) — fixed place of business
- Art. 5(2) — examples
- Art. 5(3) — construction sites
- Art. 5(4) — preparatory activities
- Art. 5(5) — dependent agents
- Art. 5(6) — independent agents
- Art. 5(7) — subsidiary

18

---

---

---

---

---

---

---

---

**Differences between OECD and UN Models**

- UN Model has 6-month rule for construction sites
- The construction site rule of the UN Model is drafted as a deeming rule
- UN Model has special rule for services and for collection of insurance premiums by dependent agents
- Dependent agent rule in UN Model applies to agent with stock of goods from which deliveries are made
- Independent agent rule in UN Model is not applicable to agent who works exclusively for one principal

19

---

---

---

---

---

---

---

---

**Fixed Base**

- Before 2000, Art. 14 used fixed base as threshold for taxing personal services
- Same as PE
- After 2000, income from services treated as business profits

20

---

---

---

---

---

---

---

---

**Taxation of Business Profits**

**Article 5(1)**  
“A fixed place of business through which the business of an enterprise is wholly or partly carried on”

**Article 7(1)**  
“The 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 PE situated therein.”

21

---

---

---

---

---

---

---

---

**Article 5(1)**

“A fixed place of business through which the business of an enterprise is wholly or partly carried on”

- “place”
- place of “business”
- “fixed” place of business
- “through which business is carried on”

22

---

---

---

---

---

---

---

---

**“Place”**

- Must be a place of business
- Must be “fixed”
- Is Canada a place? Is Toronto, Ottawa, Montreal, Calgary or Vancouver a place? Is a road or a forest a place?
- Is an office in a building a place?

23

---

---

---

---

---

---

---

---



### Place of Business

- Relationship between place and taxpayer's business?
- Owned or rented by the taxpayer?
- Right to use or use?
- At the taxpayer's disposal: "through which the business of an enterprise is wholly or partly carried on"

24

---

---

---

---

---

---

---

---

### "Business"

- What is a business?
  - Temporary businesses
- What is a place of business?
- Is a hotel room a place of business?
- Is a client's place of business the taxpayer's place of business?

25

---

---

---

---

---

---

---

---

### "Fixed"

- Geographical aspect
  - Fixed place
- Temporal aspect
- In general:
  - If more than 12 months, PE
  - If less than 6 months, not PE
  - Between 6 and 12 months?

26

---

---

---

---

---

---

---

---

**“Through which the business is carried on”**

- Business may be carried on in several places simultaneously
- Is human activity necessary: e.g., automatic equipment, websites
- How is business carried on by an enterprise? Paragraph 10 of the Commentary

27

---

---

---

---

---

---

---

---

**Paragraph 10 of the Commentary**

The business of an enterprise is carried on mainly by the entrepreneur or persons who are in a paid-employment relationship with the enterprise (personnel). This personnel includes employees and other persons receiving instructions from the enterprise (e.g. dependent agents). The powers of such personnel in its relationship with third parties are irrelevant. [...]

28

---

---

---

---

---

---

---

---

**Article 5(2)**

- Irrelevant (?) in OECD Model
- Not an inclusive definition or deeming rule
- All examples must meet requirements of Art. 5(1)
- Different in UN Model and in some Canadian treaties (eg. India and Indonesia)

29

---

---

---

---

---

---

---

---

### Construction Sites — Article 5(3)

- Construction site is PE only if it lasts more than 12 months
- Deeming rule or additional condition?
- Treatment of subcontractors
- General contractor or architect with on-site office?
- Multiple projects?
- Temporary disruptions?

30

---

---

---

---

---

---

---

---

### Preparatory Activities — Article 5(4)

- Fixed place of business is not PE if used for:
  - Storage, display, or delivery
  - Holding goods for processing by someone else
  - Purchasing goods or collecting information
  - Other preparatory or auxiliary activities

31

---

---

---

---

---

---

---

---

### EXAMPLE 1

- R Co is a construction company resident in State R. R Co is awarded two contracts for the construction of two sections of a major highway in State S. The two sections are not contiguous but both sections are part of the same highway. It takes R Co 10 months to complete each section and a total of 16 months to complete both sections.

32

---

---

---

---

---

---

---

---

**EXAMPLE 2**

- A consultant resident in State R works for a client resident in State S for a period of 10 months. The consultant has the use of an office in the client’s premises; however, his access to the office is restricted to normal business hours and he is expected to work exclusively for the client while at the client’s premises. (*Dudney v. The Queen*)

33

---

---

---

---

---

---

---

---

*Dudney v. The Queen*  
 [2000] DTC 6169 (FCA)

**Facts:**

- US resident worked for 300 days in 1994 and 40 days in 1995 in Canada
- taxpayer provided training to Pan-Canadian Petroleum employees
- had room on Pan-Canadian premises; access controlled
- moved to different building part-way through assignment

34

---

---

---

---

---

---

---

---

*Dudney v. The Queen*  
 [2000] DTC 6169 (FCA)

**Issue:**

- Did taxpayer have a fixed base in Canada?

**Held:**

- Fixed base and PE are largely the same
- Taxpayer did not have fixed base because not controlled by or identified with taxpayer

35

---

---

---

---

---

---

---

---

***Wolf v. The Queen***  
**[2002] DTC 6853 (FCA)**

- Wolf, an American engineer, works full-time in Canadair's office in Montreal for 5 years
- His income was considered to be tax-exempt by the Federal Court of Appeal

36

---

---

---

---

---

---

---

---

**The Issues**

- Canadian resident?
  - Under the Act
  - Under the treaty
- Income from a business or from employment?
  - If business income, does taxpayer have fixed base or permanent establishment?

37

---

---

---

---

---

---

---

---

**Is Wolf Resident ?**

- TCC: permanent home in both countries, although Wolf leased his Florida condo
- Tie-breaker to US because centre of vital interests was in US
- Not discussed in the FCA because CRA did not raise the issue

38

---

---

---

---

---

---

---

---

### Business or Employment?

- TCC says employment:
  - applies 2085, 2098 of 2099 the *Civil Code*
  - the main criterion is control
- FCA says business:
  - three judges, three different reasons but same conclusion
  - large number of court decisions
  - 671122 *Ontario Ltd. v. Sagaz Industries Canada Inc.*, [2001] SCJ No. 61 (SCC)

39

---

---

---

---

---

---

---

---

### Fixed base or PE?

- Following *Dudney*, CRA did not argue that there was a fixed base or PE (“rightly or wrongly” according to Décarý in FCA)

40

---

---

---

---

---

---

---

---

### *Cheek v. The Queen* [2002] 1 CTC 2115 (TCC)

**Facts:**

- US-resident radio announcer for Toronto Blue Jays visited Canada to broadcast baseball games from 1992 on
- 80 home games per season
- taxpayer spends significant portion of game day at ballpark
- broadcast lasts about 3 hours

41

---

---

---

---

---

---

---

---

*Cheek v. The Queen*  
[2002] 1 CTC 2115 (TCC)

**Issues:**

- 1) Does taxpayer have a fixed base in Canada?
- 2) Is taxpayer an entertainer (artiste)?
  - CRA dropped first argument before trial
  - Held on second issue: taxpayer is a journalist, not an entertainer

42

---

---

---

---

---

---

---

---

**EXAMPLE 3**

A transportation company resident in State R delivers goods regularly to a customer's warehouse in State S. (paragraph 4.4 of the Commentary)

43

---

---

---

---

---

---

---

---

**EXAMPLE 4**

A painter resident in State R spends three days per week for two years working in the premises of his major client in State S. The painter is provided with a pass to give him and his employees access to the client's building. He is also allowed to use a small closet to store his supplies.

44

---

---

---

---

---

---

---

---

**EXAMPLE 5**

Professor X, a resident of State R, has developed a series of courses in leadership and organizational behaviour which he gives to senior executives. For the past 10 years Professor X has been giving courses in State S at the same conference facility for two months each year.

45

---

---

---

---

---

---

---

---

**EXAMPLE 6**

S Co owns a hotel in State S. S Co contracts with X Co, a management company resident in State R, to manage the hotel. For two years X Co sends three of its employees for successive periods of 5, 11 and 8 months to manage the hotel.

46

---

---

---

---

---

---

---

---

**EXAMPLE 7**

R Co, a company resident in State R, has a contract to provide services to a company resident in State S. R Co subcontracts all (or part) of the work to another company, S Co, resident in State S. S Co does not have any contractual obligations to the client. R Co provides all of its services in connection with the contract from State R and does not send any employees to State S.

47

---

---

---

---

---

---

---

---



**Parent and Subsidiary Corporations — Article 5(7)**

- Resident corporation controlled by nonresident parent is not PE of nonresident solely because of control
- Resident corporation controlling nonresident corporation is not PE of nonresident solely because of control
- Subsidiary’s premises may be PE of parent or subsidiary may act as dependent agent of parent

48

---

---

---

---

---

---

---

---

**AGENCY PEs**

---

---

---

---

---

---

---

---

**Agency PEs — Article 5(5)**

- Agent deemed to be PE of nonresident if agent acts on behalf of nonresident and habitually exercises authority to conclude contracts
- Not applicable to agents of independent status acting in the ordinary course of their business
- Not applicable if agent’s activities are limited to preparatory activities

50

---

---

---

---

---

---

---

---

**Agency PEs — Article 5(6)**

- No PE if nonresident carries on business through agent of independent status
- If acting in the ordinary course of business
- What is an agent of independent status?
- What is acting in the ordinary course of business?
- If independent agent is not acting in ordinary course of business, Article 5(5) may apply

51

---

---

---

---

---

---

---

---

**Nonresident Insurance Companies and PEs**

- 2 U.S. insurance companies carried on business in Canada through agents
- *Knights of Columbus* (K of C) — (2008) TCC 307
- *American Income Life Insurance* (AIL) — (2008) TCC 306
- issue in both cases is whether business is carried on through PE in Canada

52

---

---

---

---

---

---

---

---

**Structure of Business**

- various types of agents
- most agents solicited applications for insurance policies
- underwriting done in United States
- policies issued in United States; 90% of applications approved
- agents maintained home offices, remunerated by commission, worked exclusively for K of C or AIL
- some supervisory agents had formal offices (AIL sign, etc.)

53

---

---

---

---

---

---

---

---

**Temporary Insurance**

- once initial premium received with application, temporary insurance coverage for 90 days or until policy issued
- cap on amount of coverage
- if coverage declined, full amount of initial premium refunded
- is provision of temporary insurance coverage a contract?

54

---

---

---

---

---

---

---

---

**Issues**

- do U.S. companies have fixed place of business PE in Canada?
  - offices of agents
- do U.S. companies have dependent agent PE in Canada?

55

---

---

---

---

---

---

---

---

**Decision**

- AIL: no PE because agents were independent
- K of C: agents were dependent but no authority to conclude contracts
- agents' offices were not fixed places of business of AIL or K of C
- government did not appeal

56

---

---

---

---

---

---

---

---

### Agency PE — AIL

- AIL agents were legally and economically independent
- TCC referred to U.S and Canadian case law and OECD Commentary
- questionable conclusion

57

---

---

---

---

---

---

---

---

### Agency PE — K of C

- no decision on this point re K of C
- if dependent, were contracts habitually concluded in Canada?
- TCC held no — conclusion of contracts in United States was not mere formality
  - temporary insurance just part of permanent policy

58

---

---

---

---

---

---

---

---

### Fixed Place of Business

- because AIL agents were independent, their offices could not be fixed places of business of AIL
- no AIL or K of C decisions made or meetings held at agents' offices
- K of C had no right of disposal over agents' offices

59

---

---

---

---

---

---

---

---

### Absence of Insurance Clause in Treaty

- Article 5(6) of UN Model deals expressly with insurance business
- OECD Commentary points out possibility that nonresident insurers can carry on substantial business without PE
- TCC drew negative inference to support conclusions

60

---

---

---

---

---

---

---

---

### Expert Testimony

- K of C had four experts
- government challenged evidence
- TCC allowed expert evidence as to right of disposal over space and inference from absence of Article 5(6) of UN Model on basis of relevance to intention of drafters of Canada-US treaty
- not evidence of domestic law

61

---

---

---

---

---

---

---

---

### *Zimmer Ltd.* (2007, CAA Paris, France)

**Facts:**

- UKCo distributed orthopedic products through a French commissionaire subsidiary
- French commissionaire could not conclude contracts in name of UKCO

**Issue:**

- Does UKCo have a PE in France under dependent agent provision of treaty?

62

---

---

---

---

---

---

---

---

### The contract

- Zimmer SAS may
  - accept orders, display quotes and documents in tender offers and conclude sales contracts on behalf of ZIMMER LTD without its prior approval
  - Negotiate prices, grant discounts or terms of payment with current or new customers without ZIMMER LTD’s prior approval

63

---

---

---

---

---

---

---

---

### According to the Court

- “it results therefore from the terms of the contract itself that Zimmer SAS had the power to bind ZIMMER LIMITED”
- “that the circumstance whereby Zimmer SAS, owing to its status as commission agent, acted in its own name and could not therefore effectively conclude contracts in the name of its principal is without effect on the power of that company to bind its principal in commercial transactions pertaining to the said principal’s own activities...”

64

---

---

---

---

---

---

---

---

### According to the Court

- “the risks stemming from the execution of products sales contracts were borne by ZIMMER LIMITED’
- “the enquiry had found that Zimmer SAS acted solely on behalf of ZIMMER LIMITED; that Zimmer SAS cannot therefore be deemed to have an “independent status” within the meaning of Article 4(4) and (5) of the abovementioned Convention”

65

---

---

---

---

---

---

---

---

**Opinion of the *Commissaire du gouvernement***

- “for the purposes of Article 4 (4) of the bilateral Convention, Zimmer SAS acts “in the name of” its principal since the term should not be taken literally but merely means that Zimmer SAS can bind Zimmer Ltd for activities specific to that company.”
- “This is the interpretation of the OECD Committee on Fiscal Affairs with regard to the provisions of the OECD Model Tax Conventions” [paragraph 32.1 of Commentary on Article 5]

66

---

---

---

---

---

---

---

---

**Paragraph 32. 1 of the Commentary**

32.1 Also, the phrase "authority to conclude contracts in the name of the enterprise" does not confine the application of the paragraph to an agent who enters into contracts literally in the name of the enterprise; the paragraph applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise....

67

---

---

---

---

---

---

---

---

**Zimmer Ltd. (Conseil d’État, France)**

**Judge Reporter’s conclusions** (January 29, 2010):

- a strict legal interpretation must be applied
- commissionaire cannot bind the principal under civil law
- rejects the previous analysis of paragraph 32.1 of Commentary on Article 5; notes that the paragraph was included at the request of the United Kingdom
- Conseil d’État usually follows Judge Reporter’s conclusions

68

---

---

---

---

---

---

---

---

SERVICES PEs

---

---

---

---

---

---

---

---

Introduction

- OECD Model definition of PE: fixed place of business and agency PE
- services PE rule found in UN Model, Article 5(3)(b)
  - similar rule in Article 14
- alternative services PE rule adopted by OECD as part of the 2008 update
- Article V(9) of the Canada-US treaty

70

---

---

---

---

---

---

---

---

United Nations Model Tax Convention, Article 5(3)(b)

3. The term “permanent establishment” also encompasses:

...

(b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than six months within any twelve-month period.

71

---

---

---

---

---

---

---

---



**United Nations Model Tax Convention, Article 14 (1)**

1. Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State:

72

---

---

---

---

---

---

---

---

**United Nations Model Tax Convention, Article 14 (1)**

(b) If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.

73

---

---

---

---

---

---

---

---

**Alternative OECD Services PE Rule**

Notwithstanding the provisions of paragraphs 1, 2 and 3, where an enterprise of a Contracting State performs services in the other Contracting State

a) through an individual who is present in that other State during a period or periods exceeding in the aggregate 183 days in any twelve month period, and more than 50 per cent of the gross revenues attributable to active business activities of the enterprise during this period or periods are derived from the services performed in that other State through that individual, or

74

---

---

---

---

---

---

---

---

Alternative OECD Services PE Rule

b) during a period or periods exceeding in the aggregate 183 days in any twelve month period, and these services are performed for the same project or for connected projects through one or more individuals who are performing such services in that other State or are present in that other State for the purpose of performing such services,

75

Horizontal lines for notes

Alternative OECD Services PE Rule

the activities carried on in that other State in performing these services shall be deemed to be carried on through a permanent establishment that the enterprise has in that other State, unless these services are limited to those mentioned in paragraph 4 which, if performed through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

76

Horizontal lines for notes

Article V(9) of Fifth Protocol

- included at Canada’s insistence
• not part of US Model and United States opposes OECD draft rule
• intended to overcome Dudney case
• based on OECD draft rule but several modifications

77

Horizontal lines for notes

### Article V(9)

- deemed PE if:
  - 1) services performed in state by individual who is present for 183 days or more and gross revenue test satisfied, or
  - 2) services performed in state for 183 days or more in respect of same or connected project for residents or nonresident with PE

78

---

---

---

---

---

---

---

---

### Article V(9): General Comments

- services must be performed for other persons, not enterprise itself
- refers to “enterprise of a Contracting State” which is not used in Canada-US treaty
- subject to exception for preparatory or auxiliary activities

79

---

---

---

---

---

---

---

---

### Relationship between Article V(9) and Construction Site Rule

- construction rule (12 months) trumps Article V(9)
- opposite result under OECD rule
- can services performed at construction site be taken into account for purposes of Article V(9)?

80

---

---

---

---

---

---

---

---

### Article V(9)(a)

- enterprise carried on by individual who performs services and is present in other country for 183 days or more
- gross revenue test will always be satisfied
- presence test applies like test in Article 15(2) of OECD Model: an individual is either present in a country or not (reason for presence is irrelevant)

81

---

---

---

---

---

---

---

---

### Article V(9)(a)

- individual performs services as employee or independent contractor on behalf of enterprise
- to prevent use of company, partnership, or sole proprietorship to avoid rule
- gross revenue test is important in these cases

82

---

---

---

---

---

---

---

---

### Gross Revenue Test

- purpose: to restrict rule to enterprises that earn most of their revenue from services
- income from individual's services must be more than 50% of enterprise's gross revenue
- based on "gross active business revenues"
- relevant period for calculation?

83

---

---

---

---

---

---

---

---

### Article V(9)(b)

- similar to UN Model
- services provided by employees or independent contractors
- services must be provided for 183 days or more

84

---

---

---

---

---

---

---

---

### Connected Projects

- services performed by related enterprises?
- services must be provided for "same or connected project"
- when are projects connected?
- Exchange of Notes indicates there must be commercial and geographical coherence
- OECD requires only commercial coherence

85

---

---

---

---

---

---

---

---

### Article V(9)(b)

- services must be provided for residents of other country or nonresidents with PE
- illustrates concern about erosion of tax base
- existence of PE determined under Canada-US treaty rules (Article V(10))
- services must be provided in respect of PE

86

---

---

---

---

---

---

---

---

*Morgan Stanley v. Com'r of Income Taxation (India SC, 2007)*

- Morgan Stanley is a large investment bank resident of US
- MSAS is a wholly-owned subsidiary resident in India
- The Morgan Stanley group has outsourced back-office functions to MSAS (IT support, account reconciliation, research on the local market etc.)
- MSAS does not interact with clients of Morgan Stanley group

87

---

---

---

---

---

---

---

---

*Morgan Stanley*

- MSAS remunerated at cost-plus 29%
- MSAS obtained registration with the Software Technology Park of India; the income from the software-related activities is exempt from Indian tax
- Decision of the Court rendered on appeal from a ruling of the Authority for Advance Rulings

88

---

---

---

---

---

---

---

---

*Employees of Morgan Stanley*

- Morgan Stanley proposes to regularly send some its employees to India for two different purposes
- Some employees are sent for "stewardship activities and other similar activities"
  - They ensure that high standards of quality are met in the provision of services by MSAS to the companies of the group
  - They travel frequently to India for very short periods

89

---

---

---

---

---

---

---

---

### Employees seconded

- Some employees are seconded to MSAS
  - At the request of MSAS, for periods ranging from several months to a couple of years
  - They work under MSAS’s control and supervision
  - They remain employed by Morgan Stanley, which continues to pay their salaries and other benefits. Under an umbrella secondment agreement between the two companies, MSAS is required to reimburse the total remuneration costs without any profit element.

90

---

---

---

---

---

---

---

---

### PE definition of US-India Treaty

- “Service PE”:**
- 2) The term "permanent establishment" includes especially: [...]
- (l) the furnishing of services, other than included services as defined in Article 12 (Royalties and Fees for Included Services), within a Contracting State by an enterprise through employees or other personnel, but only if:
- (i) activities of that nature continue within that State for a period or periods aggregating to more than 90 days within any twelve months period; or
  - (ii) the services are performed within that State for a related enterprise [within the meaning of paragraph 1 of article 9 (associated enterprises)]

91

---

---

---

---

---

---

---

---

### Position of the Tax Administration When Ruling was Requested

1. PE under “fixed place of business”
2. Service PE under 5(2)
3. Dependent agent PE

92

---

---

---

---

---

---

---

---

**Decision of the Court**

“The stewardship activity is basically to protect the interest of the customer...In such a case it cannot be said that MSCO has been rendering the services to MSAS, ...We do not agree with the ruling of the AAR that the, stewardship activity would fall under Article 5(2)(1).”

93

---

---

---

---

---

---

---

---

**Decision of the Court**

“As regards the question of deputation, we are of the view that an employee of MSCO when deputed to MSAS does not become an employee of MSAS. ...A deputationist ...lends his experience to MSAS in India as an employee of MSCO as he retains his lien and in that sense there is a service PE (MSAS) under Article 5(2)(1).”

94

---

---

---

---

---

---

---

---

**Decision of the Court**

“...as rightly held by the AAR, there is no agency PE as the PE in India had no authority to enter into or conclude the contracts. The contracts would be entered in the United States. They would be concluded in US. The implementation of those contracts only to the extent of back office functions would be carried out in India, and therefore, MSAS would not constitute an Agency PE as contended on behalf of the Department.”

95

---

---

---

---

---

---

---

---



### Decision of the Court

“As regards income attributable to the PE (MSAS), we hold that the Transactional Net Margin Method was the appropriate method for determination of the arm's length price in respect of transaction between MSCo and MSAS. We accept as correct the computation of the remuneration based on cost plus mark-up worked out at 29% on the operating costs of MSAS. ...”

96

---

---

---

---

---

---

---

---

### Decision of the Court

“As regards attribution of further profits to the PE of MSCo where the transaction between the two are held to be at arm's length, we hold that the ruling is correct in principle provided that an associated enterprise (that also constitutes a PE) is remunerated on arm's length basis taking into account all the risk-taking functions of the multinational enterprise. In such a case nothing further would be left to attribute to the PE.”

97

---

---

---

---

---

---

---

---

### Services PEs: Conclusion

- legitimizes use of services PE rules by developed and developing countries
- many policy issues:
  - why 183 days?
  - why same or connected project requirement?
  - should all independent contractors be covered?

98

---

---

---

---

---

---

---

---

### The Definition of Permanent Establishment

- evolving or eroding?
- are alternatives or fundamental changes necessary?
- if so, what changes?
- possible clarification to the Commentary?

99

---

---

---

---

---

---

---

---