

International Tax | Permanent Establishment (PE) Explained

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Lauren Huster:

Hi, I'm Lauren Huster. I'm an International Tax Director here at Barnes Dennig, and today I have my colleague Michael O'Hara with me, and we're going to talk about what is the key concept that you have to understand to even understand international tax, and that is permanent establishment often referred to as a PE. People hear it a lot, but they don't totally understand what it is. So, Michael, can you give us a little overview as to what it stands for and what it means?

Michael O'Hara:

Sure. They're typically defined similarly between treaty to treaty between the different foreign countries, but there are a few exceptions and differences that you should look for if you've been inside one foreign country and you move into another one. A permanent establishment is defined inside the tax treaties as a corporation who has a fixed place of business inside a local jurisdiction. And inside that definition, we can really pull out three key elements. First is that there exists a place of business. Secondly, inside that place of business, it's fixed or permanent. And lastly, the business wholly or partially carries their activities through that location. Some examples would be a place of management, an office or a branch or a facility and the like.

Lauren Huster:

I hear you say fixed place of business a lot. Does that necessarily mean you have to have a fixed building to create a PE?

Michael O'Hara:

No, it doesn't. Thank you for bringing up that point. Back in the summer, we had a webinar that talked about this topic in greater detail, but in short, with the changing environment of employers and employees in this post pandemic world, we're seeing an increased rate of remote workers. And this is a critical step inside the business owners that they need to understand because you could trigger a PE through a dependent agent. A dependent agent is someone who acts on behalf and carries activities on behalf of the corporation. And there's really just two kind of conditions that need to be met in order for

this not to create a permanent establishment. And first, that agent must be both legally and economically independent of the corporation. And second, that agent must be acting in the ordinary course of their own business when carrying out these activities for the corporation.

Lauren Huster:

Okay, so that's kind of a way to avoid being a PE, but if, let's say you do trigger it, what are the risks when you create a PE?

Michael O'Hara:

As I mentioned before, tax treaties vary from treaty to treaty. That's something that every single one has is the tax rate that when you create a PE that they're going to be taxed at. Some other things that we need to look at is how do you register in those countries that you moved into? And most often the taxes that you'll pay are indirect taxes, such as a goods and services tax or value added tax. The greatest risk that we see is when companies create a PE without realizing it, and with that, you fail to pay your business taxes, that can cause back taxes, interest, and penalties for the corporation.

Another risk that we see is the employer liabilities, such as registering your company correctly. Some other risks that we see are employer liabilities, such as registering your company when you move into those foreign jurisdictions that I just spoke about. And also if you have to pay payroll taxes for those employees that are employed in the local jurisdictions. Reputation damage is another aspect that we should look at.

When you're moving into a foreign jurisdiction, the first impression you should have should not be back taxes, interest, and penalties with those foreign regulators. With that, you also could increase the change of future audits with those foreign regulations since you have not filed previously. This is why it's super important that you talk to your advisors early on in the process when you're moving from country to country. So we can tell you the likelihood of you hitting a PE even we can help you with all the day-to-day actions that you need to set up before you step foot in that country.

Lauren Huster:

Yeah, it's never fun to go back and kind of fix it. So I mean, the PE is just a laundry list of items they have to do, but are there specific activities that companies can kind of know they're doing and not create a PE?

Michael O'Hara:

Yeah. If a corporation has otherwise met all conditions to create a PE, there are certain activities that are exempt. For instance, if a location is solely used for the activity defined as incidental, preparatory,



ancillary in character, those type of activities, they do not meet the qualifications of PE. For example, a storage unit that you are just using to deliver goods to a customer, that will not create a PE.

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