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Permanent establishment

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In short: A permanent establishment (PE) is a taxable presence of a foreign company in another country, such as an office, branch, long-lasting construction site or an agent who concludes contracts. If a company has a PE, the host country can tax the profits attributable to it, even if the company is registered elsewhere.

Under tax treaties, a company's business profits are taxed only in its country of residence **unless** it carries on business in the other country through a **permanent establishment**. The definition, in Article 5 of the OECD Model Tax Convention, therefore decides when a foreign company becomes taxable in a new country.

What creates a permanent establishment

- **A fixed place of business** through which the business is carried on: a place of management, branch, office, factory, workshop, or a mine or other place of extracting natural resources.
- **A building or construction site** lasting more than 12 months under the OECD Model. The UN Model, used in many treaties with developing countries, uses 6 months.
- **A dependent agent**: a person who habitually concludes contracts for the company, or habitually plays the principal role leading to contracts that are routinely concluded without material changes (wording introduced in the 2017 OECD Model).

What does not

- Activities of a **preparatory or auxiliary** character, such as storage, display or purchasing goods, or collecting information, as long as they are genuinely preparatory or auxiliary.
- Independent agents, such as brokers or general commission agents, acting in the ordinary course of their own business.
- A subsidiary does not, by itself, make its parent company have a PE.

Since the BEPS project, splitting activities between related companies to stay below these thresholds ("fragmentation") is caught by anti-avoidance rules in the 2017 OECD Model and the MLI.

Consequences

- The host country taxes the profits attributable to the PE, as if it were a separate enterprise dealing at arm's length.
- The company may need to register, file tax returns and keep accounts in the host country, and sometimes register for VAT and payroll taxes.
- The home country gives relief, by exemption or credit, under the treaty.

Remote work and digital business

Employees working from home abroad, or a founder running the company from another country, can create a PE or even move the company's tax residence, depending on the facts: how regular and lasting the arrangement is, whether the company requires it, and what authority the person has. Check this before letting key people work abroad for long periods.

Frequently asked questions

Does selling online to customers in another country create a PE?

Usually not by itself under traditional treaty rules, which require a fixed place of business or a dependent agent there. VAT and other indirect taxes can still apply.

Is a branch the same as a permanent establishment?

A registered branch is almost always a permanent establishment, but a PE can exist without any branch registration.

What if there is no treaty?

Domestic law decides when a foreign company is taxable, and its test may be broader than the treaty PE definition.

References

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