

Is Your Business Creating A Permanent Establishment in Canada?

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If so, read on as you may need to file income as well as goods and services tax returns in Canada. In a new ruling the Canada Revenue Agency (CRA) provided its views on whether or not a U.S. Company would be liable for Canadian income tax. At first review, some of the factors that triggered a Permanent Establishment (PE) would not be obvious from reading the treaty and would appear to be only minor cross border transactions with our neighbor. Examples cited by CRA include common activities carried out in the ordinary trade or business: installation services, hiring of an independent contractor, website/e-commerce, and leasing activities.

Installation services in Canada:

The first example looks at a U.S. Company engaged in the business of manufacturing, selling, installation and servicing of industrial machines. Most of the Company's activities are carried on outside of Canada: 1) all the machines are manufactured outside of Canada, 2) no inventory maintained in Canada 3) no Canadian bank account and 4) no advertising carried out in Canada.

CRA advised that a PE could have occurred in this scenario if the activities performed by the Canadian employee included:

1. the Canadian employee habitually exercising authority to conclude contracts in the name of the U.S. Company, or
2. the Canadian employee generating significant revenue for the U.S. entity. An enterprise in one contracting state will be deemed to provide services through a PE in the other contracting state if the services are performed by an individual who is present in the other country for 183 days in aggregate in a 12-month period, and more than 50 percent of the gross active business revenues of the enterprise are derived from such services performed by the individual.

Hiring an “independent’ contractor to avoid PE

Under the second scenario, the U.S. Company hired Canadian citizens and residents as independent contractors to do the sales and services functions.

The CRA said that whether or not the U.S. Company hired Canadians as independent agents acting in the ordinary course of its business would have to be reviewed against the specific facts and circumstances including an extensive review of the agreement between the U.S. Company and the contractor, between U.S. Company and its Canadian customers and between the contractor and the U.S. Company's Canadian customers. CRA noted that the U.S. Company could have a PE in Canada by virtue the agent generating significant revenue (as outlined above) regardless of whether the person performing such services was an employee or an independent agent would be irrelevant.

For the contractor to be found an independent agent acting in the ordinary course of its business, the contractor is required to be both legally and economically independent and acting in the ordinary course of its business when acting on behalf of the U.S. Company.

Advertising

In this third example, the U.S. Company established a Canadian website and had limited advertising in certain Canadian industry trade journals and other media.

Canada follows the Commentary that states the website is an intangible and cannot be a PE. However, a nonresident that establishes a website to its Canadian customers may be considered to have a Canadian PE if all of the following conditions are satisfied:

- host server located in Canada;
- business is being carried out, in whole or in part, through the operation of the website on such server;
- the host server is at the nonresident's disposal;
- the host server is generally linked to a geographic location in Canada; and
- the website is hosted by the computer server on "a more than merely temporary or tentative basis."

In addition, the CRA said that advertising activities carried out of a Canadian employee's home location would be considered a factor favoring the existence of a PE.

Leasing Activities

In this fourth example, the U.S. Company would lease a small facility as a sales office and to inventory a limited number of replacements and repair parts.

CRA said that the lease space would likely be considered a PE.

The creation of a PE, tax filing requirement, is based on facts and circumstances. Each business must evaluate their operations in detail to determine the proper treatment.

For companies with Canadian clients it is recommended you review the PE issues regularly to ensure you have not triggered any type of reporting or withholding requirements.

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