

NO.: **IT-177R2 (Consolidated)**

DATE: See *Bulletin Revisions* section

SUBJECT: INCOME TAX ACT
Permanent Establishment of a Corporation in a Province

REFERENCE: Subsections 124(1) and 124(4) of the *Income Tax Act* (the “Act”) and subsection 400(2) of the *Income Tax Regulations* (the “Regulations”)

Latest Revisions – Title, Reference, Contents, Application and Summary sections and ¶s 1-4, and 7

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Bulletin Revisions

Application

This bulletin is a consolidation of the following:

- Interpretation Bulletin IT-177R2 dated May 4, 1984;
- Special Release to IT-177R2 dated August 25, 1995; and
- subsequent amendments thereto.

For further particulars, see the “*Bulletin Revision*” section near the end of this bulletin. Unless otherwise stated, all statutory references throughout the bulletin are to the Act.

Summary

In order for a corporation to have “taxable income earned in the year in a province”, it is necessary to determine whether it has a permanent establishment in that province in the year. A corporation will have a permanent establishment in a province if it has a fixed place of business there. It may also have a permanent establishment in certain other circumstances, such as when it carries on business through an employee or agent, or uses substantial machinery or equipment in a province. Where a corporation has a permanent establishment in a province in a year, 10% of its taxable income earned in the year in that province may be deducted from its Part I tax otherwise payable.

Discussion and Interpretation

Definition

¶ 1. The term “permanent establishment” is defined in subsection 400(2) of the Regulations in connection with the determination of “taxable income earned in the year in a province” (as defined in subsection 124(4)) for purposes of the deduction under subsection 124(1).

Determination

¶ 2. To determine if a corporation has a permanent establishment in a province, it is necessary to see if the corporation meets any of the criteria in subsection 400(2) of the Regulations. This will often involve questions of fact which must be answered by the circumstances of each case. An establishment in a province is not a “permanent establishment” as contemplated in the Regulations unless a business is connected with it. Ownership by the corporation of a farm, timber land, factory or a workshop does not constitute a permanent establishment of the corporation unless it is used in its business. However, if a corporation otherwise has a permanent establishment in Canada and owns land in a province, such land is deemed to be a permanent establishment. For the purpose of determining whether a non-resident corporation has a business in a province, it should be noted that the deeming rules in section 253 apply.

Fixed Place of Business

¶ 3. If a corporation has a fixed place of business in a province, it has a permanent establishment according to the Regulations. A fixed place of business may include a place, plant or natural resource used in the day-to-day business of the corporation. It does not mean that the place of business must exist for a long time or be located in a durable building; for instance, a temporary field office on a construction site could be a fixed place of business.

Examples of fixed places of business are set out in subsection 400(2) of the Regulations but these are not exclusive nor are they absolute. A public warehouse that is used by a corporation, but that is neither owned by it nor under some measure of its control, does not constitute by itself a permanent establishment of that corporation. An office that is maintained and controlled by an employee of the corporation at the employee’s choice and expense or an office that is maintained solely to purchase merchandise is not in itself deemed to be a permanent establishment of the corporation. Where a corporation does not have **any** fixed place of business (in or outside Canada), it will have a permanent establishment in the principal place in which the corporation’s business is conducted.

Employee or Agent

¶ 4. If a corporation does not have a fixed place of business in a province, it may still have a permanent

establishment in the province if it satisfies any of the other criteria listed in subsection 400(2) of the Regulations. A corporation is deemed to have a permanent establishment in a particular place if it carries on business through an employee or agent established in that place with a general authority to contract on behalf of the corporation. The fact that a corporation has business dealings in a particular place through a commission agent, broker or other independent agent is not in itself enough to result in a permanent establishment. However, there is nothing in the law which excludes a commission agent, broker or other independent agent from the reference to an “agent” in the above-mentioned deeming rule. Therefore, a permanent establishment would be deemed to exist in a particular place where a corporation carries on business through such an agent who is established in that place and has general authority to contract for the corporation.

¶ 5. A corporation will also be deemed to have a permanent establishment if an employee or agent, established in a particular place, has a stock of goods owned by the corporation from which the employee or agent regularly fills orders. The orders may be received directly from the corporation or may come from the customers themselves. “Regularly” is taken to mean repeatedly according to an established pattern. A corporation which transacts all its business from a source outside the province through mail order and catalogue sales and does not have a stock of goods in the province will not usually have a permanent establishment in that province.

Substantial Usage of Machinery or Equipment

¶ 6. A corporation that uses substantial machinery or equipment in a particular place in a province will be deemed to have a permanent establishment in that province. The corporation need not own the machinery or equipment that it uses. The size, quantity and dollar value of machinery or equipment used in the particular place are some of the criteria to be considered in the determination of “substantial”. A comparison of the total or type of machinery or equipment used by the corporation as a whole with that used in the particular place is not relevant. Another factor that may be taken into account in the determination is whether the said machinery or equipment contributes substantially to the generation of the gross income of the corporation earned at the particular place. The display or demonstration of machinery or equipment by an agent is not a use as contemplated by subsection 400(2) of the Regulations. A permanent establishment will not be considered to exist in a province solely by reason of the fact that a bus or truck travelled through that province.

Rental Operation

¶ 7. It is a question of fact whether a rental operation constitutes the carrying on of a business or whether rents received constitute income from property. Generally, subject

to the comments in the current version of IT-420, *Non-Residents –Income Earned in Canada*, rental income of a corporation will be considered to constitute income from a business. If a corporation has rental income from real estate that is income from a business, the corporation will have a permanent establishment in each province in which it has a rental property because each property will be considered a fixed place of business. If a corporation has rental income from other business operations, a permanent establishment for those operations may or may not exist in accordance with the rules discussed in this bulletin, depending on the facts of the case.

Subsidiary of a Corporation

¶ 8. A corporation's subsidiary in a province or a subsidiary engaged in trade or business in a province does not in itself constitute a permanent establishment of the corporation. However, the subsidiary may be an agent of the corporation with general authority to contract on its behalf, in which case the corporation would be deemed to have a permanent establishment in the province (as described in ¶ 4).

Bulletin Revisions

Since the issuance of IT-177R2 on May 4, 1984, there have been no significant revisions to ¶s 2, 5, 6 and 8.

The reference in the title of the previous bulletin to “a foreign enterprise in Canada” has been deleted in order to clarify that this bulletin deals with the determination of permanent establishments for provincial allocation purposes only. [November 11, 2003]

The Reference section has been changed to more accurately reflect the content of the bulletin. [November 11, 2003]

“Content”, “Application” and “Summary” sections have been added to the bulletin, as well as headings above certain paragraphs. [November 11, 2003]

¶ 1 has been modified to delete the last sentence because the bulletin is not intended to deal with whether a foreign enterprise has a permanent establishment in Canada. In addition, a reference to subsection 124(4) of the Act has been added. [November 11, 2003]

The last sentence of ¶ 2 has been revised to clarify its meaning. [November 11, 2003]

In ¶ 3, a sentence has been added which deals with the situation described in paragraph 400(2)(a) of the Regulations. [November 11, 2003]

¶s 4 and 7 have been modified by the Special Release to IT-177R2, dated August 25, 1995.

The last sentence of ¶ 4 has been changed in order to clarify its meaning. [November 11, 2003]

Comments in ¶ 7 have been revised to indicate that they only apply in determining whether a corporation’s rental operation will constitute a permanent establishment in a province. [November 11, 2003]

Throughout the bulletin, we have revised the references to “Regulation 400” to “subsection 400(2) of the Regulations” in order to be more technically precise. [November 11, 2003]

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