

## PERMANENT ESTABLISHMENT IN THE USA: BRANCH OR SUBSIDIARY?

### DEFINITION OF A PERMANENT ESTABLISHMENT

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Nonresident taxpayers are liable for corporate income tax on income attributable to a U.S. PE. The definition of a PE is not incorporated into the internal revenue code but is defined by the related tax treaty.

Per the model treaty, Art 5 (which is modified treaty to treaty) a PE includes:

- a fixed place of business through which business of an enterprise is carried on
- especially a place of management, branch, office, factory or workshop
- a building site or construction or installation project...if it lasts longer than twelve months
- the term PE shall be deemed not to include; the use of facilities solely for the purpose of storage, display or delivery of goods belonging to the enterprise
- the term shall include agents acting on behalf of the enterprise that habitually exercises that authority to conclude contracts that are binding on the enterprise
- an enterprise shall not be deemed to have a PE if it carries business through a broker, general commission agent or any other agent of independent status, provided they are acting in the ordinary course of their business as independent agent.

Special care should be taken for services carried out longer than six months.

### DEFINITION AND MAIN DIFFERENCES BETWEEN A BRANCH AND A SUBSIDIARY

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A branch is part of a corporation and not a separate legal entity. A foreign corporation may establish a branch and commence business at any time as long as local state laws are adhered to.

States are not required to follow the tax treaties.

A subsidiary set up as a U.S. corporation is a separate legal entity created under the laws of one of the states. Note that a limited liability company is eligible to be treated as a corporation for tax purposes under the "check the box" rules.

### TAX AND ACCOUNTING OBLIGATIONS

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A U.S. branch of a foreign corporation is subject to tax on net income that is effectively connected to the U.S. business. The U.S. also maintains a branch profits tax (BPT) of 30% of the "dividend equivalent amount". The BPT can be reduced or eliminated through tax treaties.

A subsidiary set up as a U.S. corporation is taxed on its worldwide income. Foreign income of these companies is taxed at regular corporate rates, however, to avoid double taxation on income earned outside the U.S., a foreign tax credit is available for foreign taxes paid, up to the amount of U.S. tax paid.

## REGISTRATION FORMALITIES

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Advice should be obtained from legal counsel regarding the registration requirements of a branch as these vary by state or advice on the use of a limited liability company to obtain liability protection.

There is no statutory audit requirement; an audit may be required by creditors, customers or as part of the worldwide reporting. Audit reports are generally based on U.S. GAAP.

## STANDARD LEGAL OBLIGATIONS AND FORMALITIES FOR A BRANCH

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One registered, operations of a branch are similar to any other form of business, although the specific tax obligations may be different.