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Permanent Establishment: when is business carried on?

Jonathan Schwarz (Temple Tax Chambers; King's College London) · Friday, September 3rd, 2021 · Delaware law, habitual exercise

Last month my blog discussed the questions relating to corporate residence and article 4(1) of the UK-US Double Tax Treaty raised in *G E Financial Investments v HMRC* [2021] UKFTT 210 (TC). This month the focus is on the permanent establishment issues.

The case concerned a complex financing structure General Electric Company group. The taxpayer, The GE Financial Investments Ltd ("GEFI Ltd"), a UK resident company was the limited partner in a Delaware limited partnership, of which, GE Financial Investments Inc ("GEFI Inc") a Delaware corporation was the general partner. The main purpose of the limited partnership was to hold directly or indirectly financial receivables and other assets, and companies carrying on a financial trade and engage in related or incidental activities. The initial assets of the partnership were promissory notes issued by group companies that were transferred by the UK company and the US corporation to the partnership as capital contributions. Three further loans were made to group companies during the lifetime of the partnership from 2003 to 2009. The partnership terminated when the UK company transferred its partnership interest to the US corporation.

The UK company's profits over the period exceeded three-quarters of a billion dollars on which it paid US federal income tax of about $300 million.

Fixed place of business

HMRC and the taxpayer focused their argument on whether the UK company had "a fixed place of business through which the business of an enterprise is wholly or partly carried" as required by article 5(1) of the Treaty. Offices were available to the US general partner in the US.

HMRC argued that 'even if the GE offices in Stamford [Connecticut] qualify as the only viable candidate for a US fixed place of business of the LP (because GE staff there acted on behalf of the General Partner of the LP), [GE]FI's activities in the US were too limited to amount to carrying on a "business" there.'

The taxpayer argued that a business may have intermittent and quiescent periods and that as GEFI participated in the LP which made and managed a series of loans in excess of $2.8 billion, received very substantial sums by way of interest and made distributions to the partners, it was carrying on a business.

Article 3(2) reference to domestic law

The Treaty, which follows the OECD Model in this respect, has a partial definition of business in Article 3(1)(d) to include, professional services and "other activities of an independent character". The tribunal accepted, that the domestic meaning of the term was required to be applied by Article 3(2) (as did the Tribunal in *Fowler v HMRC* [2016] UKFTT 234 (TC) at [105] – [107]). This is the view expressed in the OECD Commentary.

Meaning of business

UK case law on the meaning of business has focused on the degree of activity that is needed to constitute "business", especially in conjunction with the receipt of income from property such as interest, dividends and rental income. The core requirements were found to be:

- a serious undertaking earnestly pursued
- whether the activity was a function actively pursued with reasonable or recognisable continuity,
- whether the activity had a certain amount of substance in terms of turnover
- whether the activity was conducted in a regular manner and on sound and recognised business principles, and
- whether the activities were of a kind which are commonly made by those who seek to profit by them.

In the case of entities, courts have also had regard to the purpose for which the entity is established, even though this is not always determinative.

The tribunal concluded that there was a serious undertaking, given that loans exceeding $2.8 billion were made and very substantial interest received. The loans were conducted on sound and recognised business principles. The company's objects were clearly investment business. However, the judge concluded that holding five related party loans over a six-year period, where only three of these originated with the LP, was more of a passive, sporadic or isolated activity than a regular and continuous series of activities. The judge also decided that the evidence on the activities of the company directors showed a "lack of participation in the strategic direction of the LP".

On this basis, the judge ruled that the UK company did not carry on business in the US. This decision may be contrasted with that of the Indian Supreme Court in *Formula One World Championship Ltd v Commissioner of Income Tax, International Taxation* [2017] 291 CTR 24 (Delhi) which considered the same language in article 5(1) of the India-UK Treaty.

There the Supreme Court decided that licence fees paid pursuant to a race promotion contract for the Indian F1 Grand Prix which was held over three days three times in five years gave rise to a fixed place of business in India. The taxpayers' arguments about the limited number of times and duration of the events were dismissed as "trivialisation".

Surprising positions

It is also a surprising that HMRC would take the position it did about the limited number of transactions. It is more common for tax authorities to argue that limited but repeated presence does give rise to a fixed place of business. Similarly, taxpayers will often argue that limited intermittent presence does not.

Limited partnership roles

The conclusion of the tribunal in *GEFI Ltd* seems to carry with it the implication that the company was not carrying on business at all, rather than whether it was carrying on business through a fixed place in the US. The lack of participation in the strategic direction of the limited partnership by the company is unsurprising since a limited partner does not have such role in a limited partnership. That is a matter for the general partner.

Fixed place

No argument was made about the existence of a fixed place and HMRC appear to have accepted that the US companies offices would be such a place. Even if there were only a few transactions, the offices would have been continuously at the disposal of the general partner. Since the management of the partnership's activities is entirely undertaken by the general partner in a limited partnership, the agency inherent in partnership would place the limited partner there too.

The elephant in the room – agency

There is no discussion in the judgement on the existence of an agency permanent establishment within article 5(5) of the Treaty. Under Delaware law (and indeed partnership law generally) the general partner in a limited partnership is an agent of the limited partners. As such, the general partner has authority to conclude contracts on behalf of the limited partners as required by article 5(5). Plainly, the general partner would not be an independent agent within article 5(6). The only question is whether, in conducting the partnership activities the exercise of the authority to conclude contracts was "habitual".

Although the language is different, the issues seem to travel together with the question whether a function is pursued with "reasonable or recognisable continuity" to constitute the carrying on of business. How far the context means that a similar number of transactions and the degree of continuity, as well as the time over which this is measured, is far from clear.

My next blog on this case will examine the question of UK credit for US tax paid and article 24 of the Treaty. From the parties perspective, this was perhaps the most important since the UK tax at stake was almost £125 million.

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