

Allocation of Taxable Income and Taxable Capital

References : Sections 4, Regulation 183 (sections 301, 302, 302.1, 305, 309, 319, 320, 322, 325)

Application

This bulletin replaces Interpretation Bulletin 2617 originally published March 1984 and is updated for comments contained in Information Bulletins 2740, 24-82 and 21-81.

The bulletin sets out the policy of the Corporations Tax Branch on certain issues dealing with the existence of a permanent establishment and the allocation of taxable income and taxable capital between jurisdictions (taxable income earned and taxable capital employed in Canada, in the case of non-resident corporations). The bulletin addresses allocation issues common to most corporations and does not discuss the industry unique allocation formulae utilized by the following specialty corporations (Regulation 183):

- *banks and insurance corporations (sections 304 & 321, and 303 & 331)*
- *railway, navigation and airline corporations (sections 306 & 323, 311 & 327, and 307 & 328)*
- *grain elevator operators (section 308 & 324)*
- *pipeline operators (section 310 & 326)*
- *divided businesses (section 312).*

The bulletin is provided as a guide to taxpayers and is not intended as a substitute for the relevant legislation. Any references to legislation are to the provisions of the Corporations Tax Act (Ontario) (CTA) and its Regulations, unless otherwise noted.

Introduction

1. Generally, a corporation must have a permanent establishment in Ontario before the corporation is subject to corporate taxes under the CTA. This bulletin describes some factors that are considered in determining whether a corporation has a permanent establishment in a jurisdiction.
2. Once it is established that a corporation has a permanent establishment, the corporation then uses either a general allocation formula based on “salaries and wages” and “gross revenue”, or an industry unique formula applicable to certain specialty corporations, to allocate its taxable income and taxable capital to the various jurisdictions in which the corporation has a permanent establishment. This bulletin describes factors used in determining the “gross revenue” and “salaries and wages” components of the general allocation formula. In addition, the bulletin describes the allocation treatment of partnerships and joint ventures and the special formulae which are used by finance, trust and loan corporations, and bus and truck operators.

Permanent Establishment

Fixed Place of Business

3. Pursuant to subsection 4(1), a permanent establishment exists in the place where the corporation has a fixed place of business. A fixed place of business includes a branch, mine, oil well, farm, timberland, factory, workshop, warehouse, office and agency.

Fixed Place of Business (continued)

4. The words “fixed place of business” generally imply that some type of business is being carried on by the corporation at a particular place. For example, an office, where employees of the corporation report to on a regular basis, would constitute a fixed place of business. Conversely, an office used solely for the purchase of merchandise, for storage of old records, or display purposes, would not by itself constitute a fixed place of business and a permanent establishment of the corporation.
5. A showroom, where orders are normally taken, is considered an office and hence a fixed place of business of the corporation.
6. A permanent establishment exists where an office of the corporation in a salesperson’s residence represents a fixed place of business. In making this determination, the existence of a telephone listing and telecommunications or office equipment may be taken into account. However, existing alone, these facts do not result in a fixed place of business. For a salesman’s residence to qualify as a fixed place of business, one of the following factors must be present:
 - the corporation pays rent or some other direct reimbursement either to the salesman or to another person for the use of the residence as an office, or
 - there is a place within the residence set aside as an office.

Authority to Contract and Warehouses

7. In addition to other situations, a corporation has a permanent establishment in a jurisdiction if any of the following facts apply:
 - an employee who has authority to contract on behalf of the corporation, is able to bind the corporation in most sales transactions, exercises this authority repeatedly, and is consistent in exercising this authority. “In most sales transactions” means contracting for those product lines dealt with by the employee and not the total product lines dealt with by the company
 - there is an agent (other than an independent agent that deals with more than one principal) with authority to contract on behalf of the corporation, or
 - an employee or agent has a stock of merchandise owned by the corporation from which the employee or agent regularly fills orders received directly or indirectly from customers. “Regularly” means conforming to an established pattern. A permanent establishment exists even if only a small percentage of the total sales in a province are filled from the stock within the province.

Use of Substantial Machinery and Equipment

8. A permanent establishment exists in the jurisdiction in which the corporation uses substantial machinery or equipment. This refers to use by the corporation itself, not by a sub-contractor engaged by the corporation. “Substantial” means substantial to the job being done, i.e., could the job be performed without the equipment no matter what the size or cost. Machinery and equipment of a leasing business do not qualify as a permanent establishment. The equipment must be for the company’s own use and not merely for rental.

Partnerships

9. Where the corporation is a member of a partnership, including a limited partnership, the corporation has a permanent establishment in every jurisdiction in which the partnership has a permanent establishment.

Office of a Related Corporation

10. Subsection 4(4) states that where a subsidiary controlled corporation has a presence in, or is engaged in a trade or business in a particular jurisdiction, that fact does not by itself create a permanent establishment for the parent corporation in that jurisdiction.
11. An office of a related corporation may qualify as a fixed place of business if it carries on the functions of the taxpayer where the taxpayer has no employees of its own in that jurisdiction. It is not necessary that rent be paid for the use of this office.

Non-resident Corporations

12. Pursuant to subsection 4(8), a non-resident corporation is deemed to have a permanent establishment in the jurisdiction in which the corporation produced, grew, mined, created, manufactured, fabricated, improved, packed, preserved or constructed anything in whole or in part. A permanent establishment is deemed to exist in the jurisdiction in the taxation year the non-resident corporation did any of those things, irrespective of whether the resulting product or service is to be exported from the jurisdiction and sold elsewhere.

Additional Circumstances Constituting a Permanent Establishment

13. In addition to the above factors, a corporation has a permanent establishment in a jurisdiction if the corporation:
- is an insurance corporation and is registered or licensed to conduct business in the jurisdiction
 - owns land located in that Canadian jurisdiction and the corporation otherwise has a permanent establishment in Canada
 - does not have a fixed place of business but conducts its principal business in the jurisdiction, or
 - does not otherwise have a permanent establishment in Canada under subsections 4(1) to 4(10) and the place designated in its charter or by-laws as its head office or registered office is located in the jurisdiction.

Gross Revenue

“Gross Revenue” for Allocation Purposes

14. Generally, “gross revenue” for allocation purposes is the amount shown on a corporation’s financial statements prepared under generally accepted accounting principles. Subsection 248(1) of the *Income Tax Act (Canada)* (ITA), as made applicable by clause 1(1)(a), broadly defines “gross revenue” as any amount received or receivable in the year. Subsections 302(6) and (9) of Regulation 183 further define gross revenue for allocation purposes. For purposes of allocation, the following items should be excluded from gross revenue:
- volume and early payment discounts received from suppliers
 - proceeds from the sale of capital assets (capital gains) and the sale of scrap where this activity is not the principal business of the corporation
 - reimbursements for out-of-pocket expenses. Such reimbursements should reduce the appropriate expense
 - retail sales tax and other similar taxes such as export taxes for which the corporation is acting solely as a collector
 - interest from bonds, debentures and mortgages and dividends on shares of capital stock, and
 - rentals or royalties from property that is not used in connection with the principal business operations of the corporation.
15. Volume discounts paid to customers (other than lump-sum payments at the end of the year) should be deducted in arriving at gross revenue.

How Gross Revenue is Attributed to a Permanent Establishment

16. Pursuant to subsection 302(4) of Regulation 183, the gross revenue of a corporation in the business of selling products, is generally attributed to a permanent establishment based on the location of the revenue earning activities of the corporation and the concept of “destination”. If the final destination of a shipment of goods is to a jurisdiction where the corporation has a permanent establishment then the gross revenue from the sale is attributable to that jurisdiction. If the corporation does not have a permanent establishment in the jurisdiction of final destination, the gross revenue is attributed to the jurisdiction where the person negotiating the sale is attached.
17. Gross revenue from a service that is performed in a jurisdiction where the corporation has a permanent establishment, is attributed to that permanent establishment. Where the service is performed in a jurisdiction in which the corporation does not have a permanent establishment, for example where a traveling employee performs the service, the gross revenue from the service is attributed to the permanent establishment to which the person who negotiated the service contract is attached.

How Gross Revenue is Attributed to a Permanent Establishment (continued)

18. Gross revenue from a service that is performed in part in one jurisdiction with a permanent establishment and in part at another jurisdiction with a permanent establishment, should be attributed to each jurisdiction on a reasonable basis, by reference to the value of services and work performed in each jurisdiction. The basis of allocation would depend on the facts and circumstances of the particular service.

Export Sales

19. Where a corporation makes a sale of merchandise to a customer in a foreign jurisdiction or where a customer in a foreign jurisdiction instructs that shipment of merchandise be made to another person, the allocation of revenue derived from the sale is dependant on whether the corporation has a permanent establishment in the foreign jurisdiction and on whether the corporation is subject to tax on the income or profits from the sale in the foreign jurisdiction.
- If the corporation has a permanent establishment in the foreign jurisdiction of the customer and is subject to tax on the income or profits from the sale in that foreign jurisdiction, the sale is normally allocated to that foreign jurisdiction
 - If the corporation does not have a permanent establishment in the foreign jurisdiction of the customer or is not subject to tax on the income or profits from the sale in that foreign jurisdiction due to the laws of that country or any tax treaty or convention between that country and Canada, the gross revenue from the sale is attributed to provinces or territories within Canada where the goods were produced or manufactured. Where the merchandise is manufactured in part in more than one province or territory, the gross revenue from the sale is apportioned to each province or territory of Canada using the total salaries and wages of the applicable plants (including administrative salaries and wages) involved in the manufacture or production of the merchandise in each jurisdiction.

Publishing Corporations

20. Gross revenue of publishing corporations is allocated as follows:
- Advertising revenue is allocated on the basis of units of circulation in a jurisdiction
 - Circulation revenue is allocated on the basis of destination of shipment of publications
 - Other revenue is allocated on the same basis as regular sales.

Leasing Corporations

21. Gross revenue of leasing corporations is generally allocated to the jurisdiction in which the customer is situated. If the corporation does not have a permanent establishment in the jurisdiction of the customer, gross revenue is allocated to the permanent establishment of the jurisdiction in which the lease is negotiated

Permanent Establishment - Part of the Year

22. If a permanent establishment exists for any part of a year, the gross revenue for the whole year arising in that jurisdiction should be allocated to that permanent establishment

Salaries and Wages

“Salaries and Wages” for Allocation Purposes

23. “Salaries and wages” are defined in subsection 248(1) of the ITA. Subsections 302(6) to (8) and section 302.1 of Regulation 183 further define salaries and wages. For allocation purposes, the computation of salaries and wages paid in the year should reflect the following considerations:
- Salaries and wages are allocated to the permanent establishment to which the employee is attached even though the employee may sometimes travel to perform duties elsewhere

“Salaries and Wages” for Allocation Purposes (continued)

- Taxable benefits paid to officers and employees and allowed as a deduction to the corporation are to be included in salaries and wages
- Commissions paid to an independent agent are not included in salaries and wages. Commissions paid to an employee are included
- Fees paid to directors who are not employees should be excluded from salaries and wages
- Payments for superannuation, pension benefits and retiring allowances are excluded from salaries and wages
- Pursuant to subsection 302(7) of Regulation 183, a fee paid to a person to perform services for the corporation that would “normally” be performed by employees of the corporation is deemed to be salary paid in the year. The Branch adopts the federal interpretation of the word normally as found in paragraph 19 of federal Interpretation Bulletin IT-145R. Paragraph 19 states: “*The term ‘normally’ means ‘commonly’, ‘usually’, or ‘under normal or ordinary conditions’. It would apply in cases where a corporation usually performs certain services or functions itself but for some reason, such as lack of capacity, short run economic conditions, labour problems or machinery breakdowns, has sublet all or part of the work to third parties.*”
- Section 302.1 of Regulation 183 applies where Ontario’s share of taxable income and taxable capital has been unreasonably reduced by a central paymaster arrangement. A central paymaster arrangement occurs where one corporation (employer) in a related group pays the salaries to employees who work for more than one corporation in that group. When section 302.1 applies, the portion of the fee paid that may reasonably be regarded as relating to salaries for services provided in Ontario for the benefit of or on behalf of the corporation, is deemed to be salary of the corporation.

Partnership and Joint Ventures

Partnerships

24. Subsection 302(6) of Regulation 183 requires a corporation with an interest in a partnership to include a portion of the partnership’s gross revenue and salaries and wages for allocation purposes. The portion included is computed using the same proportion as the share of the profits or loss to which the corporation is entitled under the partnership agreement for the fiscal period of the partnership ending in or coinciding with the corporation’s taxation year.
25. The corporation’s share of the partnership’s gross revenue and salaries and wages is allocated to each jurisdiction in which either the corporation or partnership has a permanent establishment.

Joint Ventures

26. Consistent with the rules utilized by a corporation with an interest in a partnership, a corporation engaged in a joint venture (other than an oil and gas joint venture) is required to include a portion of the gross revenue and salaries and wages paid by the joint venture for allocation purposes, based on the ratio of the co-venturer’s share of profit and loss.
27. An exception to this rule is provided for the allocation of salaries and wages of a joint venture in the oil and gas industry. As an administrative concession, oil and gas corporate co-venturers are allowed to use the “T4 method” to allocate the salaries and wages of the joint venture to the co-venturers. Under this method, the salaries and wages paid by each co-venturer are attributed to that co-venturer and included in the co-venturer’s salaries and wages for allocation purposes.

Finance, Trust and Loan Corporations

Allocation Formulas and Types of Corporations

28. Trust and loan companies use an industry unique formula in allocating taxable income and taxable paid-up capital which includes gross revenue only and excludes salaries and wages.
29. A corporation that is not registered as a trust or loan corporation whose principal business is the making of loans must use this special formula.
30. Finance and acceptance corporations whose principal activity is discounting commercial paper as opposed to direct money-lending, are **not** considered to be loan corporations and must use the general allocation formula, using both gross revenue and salaries and wages.

Gross Revenue Inclusions of Trust and Loan Corporations

31. Subsection 302(9) of Regulation 183 excludes income from certain types of property from gross revenue for allocation purposes. This provision does not apply to a corporation using the special allocation formula for trust and loan corporations. In the case of a trust or loan corporation, the property income is considered to arise from the taxpayer's business and therefore forms part of gross revenue.

Bus and Truck Operators

Factors Not Constituting a Permanent Establishment

32. The comments in paragraphs 3 to 13 apply with necessary modifications in determining whether a bus and truck operator has a permanent establishment in a particular jurisdiction. However, in the case of bus and truck operators the following circumstances do **not** in themselves constitute a permanent establishment:
- driving through a jurisdiction
 - holding a permit or a license to operate in a jurisdiction
 - use of a warehouse or depot that is not owned nor rented and controlled by the corporation, and
 - loading and unloading trucks in a jurisdiction.

Allocation Formula

33. Bus and truck operators must allocate their taxable income and taxable capital to jurisdictions where there is a permanent establishment by using an allocation formula based on salaries and wages and distance driven.
34. Only the distance driven in jurisdictions in which the corporation has a permanent establishment is used in the allocation formula.

For More Information

For further information, please contact Desk Audit, general tax enquiries

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