Income Effectively Connected with a United States Trade or Business or Attributable to a Permanent Establishment

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By Frederick R. Chilton, Jr.*

I. INTRODUCTION

Foreign corporations may be subject to federal income tax in one of two ways, depending on whether or not the income is effectively connected with the foreign corporation's United States trade or business. If a foreign corporation is not engaged in a trade or business within the United States, it is subject only to United States income tax on passive, United States source income. In the absence of an income tax treaty, dividends, interest, rents, royalties, and other "fixed or determinable" annual or periodical income (FADPI) paid by United States residents and corporations to nonresident individuals and foreign corporations are subject to United States withholding tax at the rate of 30%. I.R.C. §§ 871(a), 881(a), 1441(a) and 1442(a) (1982). A foreign corporation not engaged in a United States trade or business is generally exempt from United States income tax on capital gains.** See S. Rep. No. 1707, 89th Cong., 2d Sess. 1065 (1966).

If, on the other hand, a foreign corporation is engaged in business in the United States, it is taxed on its income that is effectively connected (defined infra) with that trade or business at the regular corporate rate of up to 46%. I.R.C. § 882(a). Capital

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* This outline was prepared for Mr. Chilton's presentation and was provided to all attendees.
** The exceptions to this rule are I.R.C. §§ 897 and 882(d), which concern taxation of gains from U.S. real estate.
gain which is effectively connected with a United States trade or business is subject to United States tax, but at a rate of 28%. I.R.C. §§ 864(c)(2), 871(b), 882, and 1201(a).

Under income tax treaties, foreign corporations are taxed in a similar, yet different, fashion from that previously discussed. A foreign entity having a U.S. permanent establishment is taxed on income which is attributable to the permanent establishment at the federal corporate rate. If the income is not attributable to a permanent establishment, it will be subject to federal withholding tax or no federal tax.

II. INCOME EFFECTIVELY CONNECTED WITH A UNITED STATES TRADE OR BUSINESS

A. U.S. trade or business

1. Generally

To determine whether a foreign entity is engaged in a trade or business within the United States, the general view is that two related concepts must be considered: the degree or quantity of contact with the United States, and the quality of those contacts. The Linen Thread Company, Ltd. v. Commissioner, 14 T.C. 725, 736 (1950). That is, "to constitute being 'engaged in a trade or business,' there must be (1) continuity of activity, and (2) the active pursuit of profit." See generally S. Roberts & W. Warren, U.S. Income Taxation of Foreign Corporations and Non-Resident Aliens ¶ V/2 (PLI 1966). While the concepts overlap, they are distinct, and it is necessary to consider them separately.

a. Continuity

The concept of continuity has been articulated in different ways. In general, what is envisioned is the degree of contact with the United States in terms of time, Linen Thread, supra, at 736 ("continuity of sustained activity in the United States"), and Elizabeth Herbert v. Commissioner, 30 T.C. 26, 33 (1958), acq. 1958-2 C.B. 6 ("continuous and regular"), and substance, Elizabeth Herbert, supra, at 33 ("considerable"). Another element is the relative importance of the United States activity to the foreign corporation's other activities. Thus, whether a foreign corporation
is engaged in a United States trade or business depends upon the facts in each case. *European Naval Stores v. Commissioner*, 11 T.C. 127 (1948), acq. 1948-2 C.B. 2. One or two transactions within the United States may or may not constitute a United States trade or business depending upon the circumstances. *Compare* 14 T.C. 725 (1950) (two sales carried on the books of the U.S. office were not enough to constitute a trade or business), and 11 T.C. 127 (1948) (one sale did not constitute a business) *with* Rev. Rul. 58-63, 1958-1 C.B. 624 (in dicta, one horserace constituted a United States trade or business).

A foreign corporation may be engaged in business in the United States directly or indirectly through its agents. *See* I.R.C. § 864(c). For example, agency-type arrangements between a taxpayer and a United States person might give rise to a principal-agent relationship, which could result in a foreign corporation being engaged in a United States business. Rev. Rul. 70-424, 1970-2 C.B. 150.

In *Inez de Amodio v. Commissioner*, 34 T.C. 894 (1960), *aff’d without deciding this issue*, 299 F.2d 623 (3d Cir. 1962), the taxpayer was an individual who resided in Switzerland. Over a period of approximately six years, he traveled to the United States four times. On two of those visits he instructed his agent to acquire certain real estate on his behalf. Real estate companies were hired to manage the property and a trust company made mortgage principal and interest payments out of rental income. The court held the non-resident taxpayer to be engaged in a trade or business in the U.S. as a result of activities performed on his behalf by an independent agent in the U.S. The court relied upon *Jan Casimir Lewenhaupt v. Commissioner*, 20 T.C. 151 (1953), *aff’d*, 221 F.2d 227 (9th Cir. 1955), in which the Court held that a nonresident was engaged in a trade or business in the United States as a result of acquir-
ing property and managing it through a resident agent. In both cases, the taxpayers acquired several real estate interests and the agents, particularly in *Lewenhaupt*, had broad powers with respect to the property. See I.R.C. § 864(c)(5).

These cases should be compared with *Elizabeth Herbert v. Commissioner*, 30 T.C. 26 (1958). In that case, the issue was whether the taxpayer was engaged in a trade or business through a permanent establishment in the United States under the then-current United States-United Kingdom Treaty. The taxpayer and her sister received property as a gift from their father and continued to hold it as tenants in common. The lessee had charge of the premises under the long-term lease and was responsible for all repairs except for those to the outer walls and foundation. Accounting for rents and supervision of occasional repairs were carried out by employees of a corporation in which the taxpayer had an interest pursuant to a power of attorney which the taxpayer gave her sister. The taxpayer traveled to the United States every two or three years. She owned no other property in the United States.

The court first inferred that the mere ownership of property and receipt of rental income did not constitute engaging in trade or business under the then-current United States-United Kingdom Income Tax Treaty because article IX of the treaty imposed a reduced withholding tax on rental income earned by those “not engaged in trade or business in the United States.” *Id.* at 32-33. It noted that ownership and rental of real property combined with certain minimal activities did not constitute engaging in a United States trade or business. The court concluded, consequently, that the taxpayer’s activities, which were “sporadic rather than continuous, were irregular rather than regular and were minimal rather than considerable,” did not constitute engaging in a United States trade or business. *Id.* at 33.
Thus, while stock or securities transactions may be undertaken through resident brokers or commission agents without creating a U.S. trade or business, under I.R.C. § 864(b), a U.S. trade or business may arise if an agent has authority to negotiate and conclude non-securities contracts on a taxpayer's behalf. See 20 T.C. 151 (1953); cf. I.R.C. §§ 864(c)(5)(A). Also, it has been suggested that if an agent has discretionary power to act on behalf of its principal, the agent's activities may constitute engaging in a United States trade or business by the foreign business. Rev. Rul. 55-282, 1955-1 C.B. 634.

Aside from situations involving U.S. agents, the only way in which a foreign corporation may have a United States trade or business is through its employees. Cf. Daily Journal Co. v. Commissioner, 135 F.2d 687 (9th Cir. 1943). An employee of a company will be held to be acting for his company when he holds himself out to be acting on behalf of the company and carrying out the business in which the employer is engaged. See Commissioner v. Consolidated Premium Iron Ores, Limited, 265 F.2d 320 (6th Cir. 1959); Daily Journal Co. v. Commissioner, 135 F.2d 687 (9th Cir. 1943).

Piedras Negras Broadcasting Co. v. Commissioner, 43 B.T.A. 297 (1941), concerned a Mexican corporation that broadcast radio programs into the United States from a station in Mexico. It received compensation for advertising, which it carried in the form of a portion of the proceeds received by mail from listeners. The basement of a hotel in the United States, to which the mail was delivered, was used by the taxpayers and its advertisers' representatives to sort the mail and to divide the proceeds. The Mexican corporation did not have exclusive use of the basement because unrelated salesmen staying at the hotel used the basement for their wares. The Mexican corpora-
tion's share of the proceeds was deposited in a U.S. bank account.

One issue was whether the Mexican corporation was engaged in a United States trade or business. Another issue was the source of income. One of the Internal Revenue Service's (IRS) arguments relating to the sourcing question was that income derived from a United States trade or business was United States source income,* and that the taxpayer was engaged in a United States trade or business. The court found that the taxpayer was not engaged in a United States trade or business and that it did not have a United States office or place of business,** apparently because there was insufficient continuity and contact with the United States.

In contrast, in Rev. Rul. 58-63, supra, the IRS indicated that one horserace in the United States constituted engaging in a United States trade or business. That ruling concerned an individual who owned a racing stable as a business in France. He was invited to and did enter a horse in a single race in the United States. He accompanied the horse to the United States and participated in the social events which accompanied the race. The ruling stated in dicta that the individual was engaged in a trade or business within the United States. It stated further that the proceeds from the race were industrial and commercial profits. The court held, however, that the individual had no permanent establishment within the United States and therefore was not subject to U.S.

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* Under the present Code, income effectively connected with a United States trade or business is not necessarily United States source income. See I.R.C. § 861; cf. I.R.C. § 864(c)(4).

** The statute under which the case was decided imposed United States corporate tax on foreign corporations “engaged in trade or business within the United States or having an office or place of business therein” and imposed U.S. withholding tax on foreign corporations not so engaged. While the two concepts, i.e., engaged in trade or business and office or place of business are similar, they are distinct. See Scottish American Investment Co., Ltd. v. Commissioner, 12 T.C. 49 (1949). Unfortunately, the Court did not focus on this distinction in Piedras Negras.
tax because of the United States-France treaty (Convention About Double Taxation and Fiscal Assistance, October 18, 1946, United States-France, 64 Stat. (3) B3, T.I.A.S. No. 1982). Unfortunately, the ruling did not indicate the length of stay within the United States or what preparations had to be made for the horserace. The reason for the omission may have been that the IRS focused on the nature of the activities, *i.e.*, whether the activities were in the active pursuit of profit. Another possible interpretation is that the ruling implies a test of relativity: that the taxpayer's activities in the United States must be compared with those throughout the world.*

b. The active pursuit of business

The second feature relating to a United States trade or business is the quality of the activity; *i.e.*, whether the activity is in the active pursuit of profit. The case law regarding this issue gives some guidance as to the activities that an investment-oriented company may engage in without becoming engaged in a United States trade or business. This issue concerns the question of whether the activity is business or investment-related. It is closely related to the trade or business concept of I.R.C. § 162. See Werner Abegg v. Commissioner, 50 T.C. 145 (1968), aff'd, 429 F.2d 1209 (2d Cir. 1970), cert. denied, 400 U.S. 1008 (1971); European Naval Stores Co. v. Commissioner, 11 T.C. 127 (1948).

*Werner Abegg* concerned a foreign corporation which held stock in a United States corporation. The taxpayer asserted that it was engaged in a United States trade or business.** Its president was

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* Roberts and Warren use examples of two different corporations to illustrate this concept. A foreign manufacturer of large hydroelectric generators may make only one or two sales each year. If its only sale for the year is in the United States, it may be found to be engaged in a trade or business in the United States. On the other hand, a manufacturer who sells two million flashlights each year may not be engaged in trade or business in the United States merely as a result of the sale of ten flashlights therein. S. Roberts & W. Warren, *supra*, p. 498, at 9.

** The taxpayer had approximately $100,000 of expenses relating to the U.S. business,
also president of the American subsidiary and had his office in New York. One of the president’s responsibilities was to review potential investments in addition to general management responsibilities. The board of directors occasionally met in New York. The court said that the foreign corporation’s activities “were confined to holding securities and cash and the purchase and sale of investment securities.” 50 T.C. at 154. It held that “[t]hese activities do not amount to engaging in business.” Id. With respect to the president’s activities in searching for investments, the court cited cases arising under I.R.C. § 162, holding that searching for business opportunities does not constitute engaging in business. Thus, the court seems to have relied on the general trade or business concepts under I.R.C. § 162.

*European Naval Stores Co. v. Commissioner*, 11 T.C. 127 (1948), involved a foreign corporation in the naval stores business. During the year in question, the taxpayer purchased naval stores from a sister United States corporation between twenty and thirty times. All of the purchases were negotiated and closed by letter and cable. Due to the outbreak of World War II, some goods ordered and paid for by the taxpayer were not transported from the United States. The United States company stored the goods for the taxpayer and, after a period of time, repurchased them at a profit to the taxpayer. This was the taxpayer’s only sale in the United States. It had no officers, factory, plant, showroom, or salespeople within the United States. The court stated that the question was one of fact. Id. at 127. While the court could have easily decided the case on the basis of the continuity issue, its opinion was based on the pursuit of profit:

It could hardly be contended that this isolated sale was of the type for which

which made it more advantageous to the taxpayer to pay United States net income tax rather than gross (withholding) tax. *Werner Abegg v. Commissioner*, 50 T.C. at 153.
the corporation was organized, or that, as far as petitioner was concerned, the purpose was to realize a profit . . . .

[T]his sale was not made in the regular course of the trade in which petitioner was engaged, but was the result of an assumption of authority and was more in the nature of a salvage operation . . . .

Id. at 134.

Another line of cases involving bookkeeping offices, *Scottish American Investment Co., Ltd. v. Commissioner*, 12 T.C. 49 (1949), concerned United Kingdom investment trusts which invested funds within and without the United States to obtain income. Each company had a board of directors which met at the home office in Scotland. All decisions regarding purchases and sales of securities and investment policies were made by the home office. Prior to the years in question, the taxpayer established a U.S. office in Jersey City, New Jersey. The office was managed by a partner in the taxpayers' accounting firm and consisted of one large room. The office was empowered to collect and deposit dividend and interest income, to maintain records, file tax returns, and to execute and file proxies, subject to consultation with the home office. U.S. securities of the taxpayers were held by a New York bank. The taxpayers contended that they were engaged in a United States trade or business.

The case provides an interesting history regarding the status of United States bookkeeping offices of foreign investment companies. In a case involving the same taxpayers for an earlier year, *Scottish American Investment Co., Ltd. v. Commissioner*, 47 B.T.A. 474, aff'd, 139 F.2d 419 (4th Cir. 1943), contra, 142 F.2d 401 (3d Cir. 1944), aff'd, 323 U.S. 119 (1944), it was held that the taxpayers "had within the United States an office or place of business" for purposes of section 231(b) of the
Revenue Acts of 1936 and 1938. 47 B.T.A. at 483. The court "did not decide whether petitioners were engaged in business within the United States."* 12 T.C. at 55.

In the second line of cases involving Scottish American Investment Co., the issue of whether the taxpayers were engaged in business within the United States had to be considered due to changes in the statute by the Revenue Act of 1942. The Tax Court concluded that all major decisions regarding the taxpayers' business were made in Scotland and that the activities of the United States office were confined to routine and clerical functions. The court concluded accordingly that the taxpayers were not engaged in business within the United States. *Id.* at 59.

In reaching this conclusion, the court took into account the legislative history of the Revenue Act of 1942. The committee reports relating to that legislation noted that foreign corporations which had held substantial U.S. stock had contended that they had U.S. offices in order to be taxed on a net basis. H.R. Rep. No. 2333, 77th Cong., 2d Sess. 103 (1942); S. Rep. No. 1631, 77th Cong., 2d Sess. 135 (1942). Congress decided that since these corporations "engage[d] in no other economic activities in the United States, they cannot be said to be engaged in trade or business within the United States." 12 T.C. at 57-58. Accordingly, Congress amended the statute so that the standard regarding foreigners was a single one; *i.e.*, whether the taxpayer engaged in a trade or business in the United States. The Court observed that the question involves a "matter of degree, based upon both a quantitative and a qualitative analysis of the

* Both the Tax Court and Supreme Court in the earlier case did not consider the question of "trade or business" since they found there was a United States office. The Third Circuit considered the trade or business issue and found that the establishment did not constitute a United States trade or business. 142 F.2d at 402.
services performed” and held that the taxpayers were not engaged in a United States trade or business. *Id.* at 59. The court said that it was “not convinced that the services of this local office, quantitatively extensive and useful as they may have been, approached that quality” which was necessary to constitute a trade or business. *Id.*

Rev. Rul. 55-182, 1955-1 C.B. 77, concerned a Canadian investment company. The corporation's home office, where all investment decisions were made, was in Canada. It had no United States office, but occasional special meetings of the board of directors were held in the United States, and stock in the corporation was offered for sale in the United States. The IRS held the corporation was not engaged in a United States trade or business.

Based on the foregoing, it appears that a foreign corporation might engage in certain limited activities within the United States without being engaged in a United States trade or business. It would be prudent, however, to limit activities within the United States to a minimum. An occasional board of directors meeting in the United States would not constitute a United States trade or business, Rev. Rul. 55-182, *supra,* and maintaining a set of books in the United States would not constitute engaging in a United States business. As was noted above, whether a foreign corporation is engaged in a United States business may turn on a comparison of the corporation’s foreign and domestic activities. That is, it may be necessary to compare the functions performed within and without the United States. *Cf.* Treas. Reg. § 1.864-2(c)(2)(iii) (1968).

2. Partnerships

Where a partnership is engaged in trade or business in the United States, each nonresident alien member thereof is considered to be so engaged. I.R.C. § 875 (1982). This rule would apply even to a partner who
had no contact with the United States other than his ownership of an interest in the partnership.

B. Effectively connected income

1. Introduction

Prior to enactment of the Foreign Investors Tax Act of 1966, the Internal Revenue Code applied the "force of attraction" principle. Under this principle, if a foreign taxpayer was engaged in trade or business in the United States, all of the taxpayer's income from United States sources was "attracted" to the trade or business without regard to the relationship of the income to the United States business, thereby subjecting all such income to United States taxation at the regular rates applied to taxable income. Thus, if a foreign corporation was engaged in trade or business in the United States at any time during the taxable year, it would be subject to United States tax at the regular rates on all of its taxable investment income from United States sources, whether or not such income was connected with the trade or business carried on in the United States. Had the foreign taxpayer not been engaged in trade or business in the United States, that income would have been subject to tax at the flat 30% rate applied to gross income.

The force of attraction concept only applied to U.S. source income; foreign source income of foreign taxpayers was not subject to federal tax even if they had a U.S. trade or business. Consequently, foreign corporations were able to conduct foreign sales operations from U.S. offices and escape U.S. tax.

The Foreign Investors Tax Act of 1966 replaced the force of attraction concept (in part) with the concept of effectively connected income. Now capital gain and FADPI which are not related to a U.S. trade or business are not subject to corporate tax, but FADPI is subject to withholding tax. Under the concept of effectively connected income, foreign source income which is attributable to a U.S. trade or business may be subject to U.S. corporate tax.
2. U.S. source income

Whether U.S. source income is effectively connected with a United States trade or business is determined in several ways. FADPI and gain from the sale or exchange of capital assets are effectively connected with the conduct of a United States trade or business if the income (or loss) is derived from assets used in or held for use in the conduct of such trade or business or if the activities of such trade or business were a material factor in the realization of the income (or loss). I.R.C. § 864(c)(2). All other types of ordinary income from sources within the United States are treated as effectively connected with the conduct of a trade or business within the United States. I.R.C. § 864(c)(3). Therefore, ordinary income, other than FADPI (i.e., business income) is deemed to be effectively connected (under the old force of attraction concept) with the conduct of a United States trade or business if the income is from United States sources. Treas. Reg. § 1.864-4(b), Ex. 3.

a. Asset use test

Ordinarily, an asset shall be treated as used in, or held for use in, the conduct of a trade or business in the United States if the asset is (a) [h]eld for the principal purpose of promoting the present conduct of the trade or business in the United States, as, for example, in the case of stock acquired and held to assure a constant source of supply for the trade or business; or (b) [a]cquired and held in the ordinary course of the trade or business conducted in the United States, as, for example, in the case of an account or note receivable arising from that trade or business[,] or (c) [o]therwise held in a direct relationship to the trade or business conducted in the United States.


In determining whether an asset is held in a direct relationship to the trade or business conducted in the
United States, a principal consideration is whether the asset is needed in that trade or business. An asset is considered needed in a trade or business "only if the asset is held to meet the present needs of that trade or business and not its anticipated future needs." Treas. Reg. § 1.864-4(c)(2)(iii).

b. Business activities test

The business activities test is ordinarily applied in making a determination with respect to income, gain, or loss which, even though generally of the passive type, arises directly from the active conduct of the taxpayer's trade or business in the United States. The business activities test is of primary significance, for example, where (a) dividends or interest are derived by a dealer in stocks or securities, (b) gain or loss is derived from the sale or exchange of capital assets in the active conduct of a trade or business by an investment company, (c) royalties are derived in the active conduct of a business consisting of the licensing of patents or similar intangible property, or (d) service fees are derived in the active conduct of a servicing business.


c. Business income

While the force of attraction rule was replaced with the concept of effectively connected income, the force of attraction concept still exists with respect to business income. It is illustrated by the following example:

Foreign corporation S . . . is engaged in the business of purchasing and selling electronic equipment. The home office of such corporation is also engaged in the business of purchasing and selling vintage wines. During 1968, S establishes a branch office in the United States to sell electronic equipment to customers, some
of whom are located in the United States and the balance, in foreign countries. This branch office is not equipped to sell, and does not participate in sales of, wine purchased by the home office. Negotiations for the sales of the electronic equipment take place in the United States. By reason of the activity of its branch office in the United States, S is engaged in business in the United States during 1968. As a result of advertisements which the home office of S places in periodicals sold in the United States, customers in the United States frequently place orders for the purchase of wines with the home office in the foreign country, and the home office makes sales of wine in 1968 directly to such customers without routing the transactions through its branch office in the United States. The income or loss from sources within the United States for 1968 from sales of electronic equipment by the branch office, together with the income or loss from sources within the United States for that year from sales of wine by the home office, is treated as effectively connected for that year with the conduct of a business in the United States by S.

Treas. Reg. § 1.864-4(b), Ex. 3.

3. Foreign source income
Income from sources without the United States is only treated as effectively connected with the U.S. trade or business of a corporation or individual if such person has an office or other fixed place of business in the U.S. to which such gain is attributable and it is:

a. rents or royalties for the use of or for the privilege of using intangible property (including gain or loss realized on the sale or exchange of such property) derived in the active conduct of such trade or business;

b. certain gains from the banking or financing business;
c. certain income from insurance activities;
d. from the sale or exchange through such office or other fixed place of business of inventory, except that such foreign source income will not be effectively connected if the property is sold or exchanged for use, consumption, or disposition outside the United States and an office or other fixed place of business of the taxpayer outside the United States participated materially in such sale. Treas. Reg. § 1.864-5(b) (1972).

To be a material factor with respect to a foreign source sale or for a sale to be attributable to a U.S. office, the United States or foreign office must provide a “significant contribution” or be an “essential economic element” in the production of the income. Treas. Reg. § 1.864-6(b). An office will be considered a material factor in the production of sales income if it “actively participates in soliciting orders, negotiating . . . contract[s] of sale or performing other significant services necessary for the consummation of [sales].” Treas. Reg. § 1.864-6(b)(2)(iii) (1972).

III. INDUSTRIAL AND COMMERCIAL PROFITS ATTRIBUTABLE TO A PERMANENT ESTABLISHMENT

United States income tax treaties generally provide that industrial or commercial profits of a resident of a country with which the U.S. has a treaty shall be exempt from tax by the United States unless the resident of the other country is engaged in industrial or commercial activity in the United States through a permanent establishment situated in the United States. See, e.g., Article 8, Income Tax Treaty between Japan and the United States (hereinafter Japanese Treaty). If a resident of the other country is engaged in industrial or commercial activity in the United States through a permanent establishment, United States income tax may be imposed on the industrial and commercial profits attributable to the United States permanent establishment. See, e.g., Article 8 of the Japanese Treaty, and Article 7 of the Income Tax Treaty between the United Kingdom and the United States (hereinafter U.K. Treaty).
The first issue to be considered is whether a foreign corporation is engaged in activity in the United States through a permanent establishment. While the terms "permanent establishment" and "trade or business" are similar, they are not the same. See Rev. Rul. 58-63, supra. The definition of permanent establishment is divided into two separate categories: (1) a fixed place of business; and (2) an agency. The term fixed place of business includes: (1) a branch; (2) an office; (3) a factory; (4) a workshop; (5) a warehouse, etc. Article 9(2) of the Japanese Treaty and Article 5 of the U.K. Treaty. An office or showroom used by salesmen for sales promotion is also a fixed place of business. See Rev. Rul. 62-31, 1962-1 C.B. 367; Rev. Rul. 65-263, 1965-2 C.B. 561. Notwithstanding the foregoing, a permanent establishment shall not include a fixed place of business used only for one of the following: storage or display of goods belonging to the foreign corporation; the maintenance of a stock of goods belonging to the corporation for the purpose of processing by another person; the purchase of goods or merchandise or the collection of information for the corporation; advertising; and the supply of information, the conduct of scientific research, or similar activities which have a preparatory or auxiliary character for the corporation. Article 9(3) of the Japanese Treaty.

The second part of the definition relating to permanent establishment concerns an agency. A person acting in the United States on behalf of a foreign resident, other than an agent of independent status, shall be deemed to be a permanent establishment in the United States of the corporation, if such person has and habitually exercises authority to conclude contracts in the name of the foreign resident, unless the exercise of such authority is limited to the purchase of goods or merchandise for that resident. Article 9(4) of the Japanese Treaty. As can be seen from the foregoing, the term fixed place of business is broad enough to encompass almost every type of office of commercial establishment, and thus, such facilities generally constitute permanent establishments.

Income which is attributable to the permanent establishment is income which the United States office has played a part in earning. Rev. Rul. 81-78, 1981 C.B. 604. Thus, "income attributable to a permanent establishment" may be different from "income
effectively connected with a U.S. trade or business.” Attributable income often includes both foreign source and United States source income. See Article 7 of the Technical Explanation to the U.K. Treaty. Thus, sales to foreign customers for which a United States permanent establishment was responsible would be subject to United States tax.