

***Foreign managing directors, board members & authorized signatories
- wage tax and criminal law risks -
(Excerpt PwC P&O Newsletter November 2021*)***

Recently, there has been an increase in discussions with the German tax authorities about cases where managing directors, board members and, in some cases, authorized signatories of German companies reside abroad and work for and in the interest of a German legal entity.

In this context, the German tax authorities assess in particular whether the employer would be legally obliged to withhold respective wage tax amounts for the above-mentioned business activity in Germany and if this obligation has already existed in the past (for up to 10 years). The above-mentioned topic is a typical subject of wage tax audits. In individual cases even first criminal pre-investigations were initiated by the responsible authorities.

For this purpose, the tax authorities can use publicly accessible sources of information, in particular the commercial register (e.g., entry of a possible foreign residence) as well as other data available to the German tax authorities.

Background

Depending on the relevant double taxation agreement, remuneration for foreign managing directors, board members and authorized signatories may be subject to wage- and income tax in Germany. However, this is possible even without the existence of working days in Germany.

The aforementioned issues particularly affect foreign managing directors, board members and, if applicable, authorized signatories ("Prokuristen") of German companies who are subject to double taxation agreements (DTAs) with a special regulation allocating the right for taxation for remuneration of managing directors, board member and authorized signatories to Germany, **irrespective in which country their business activity is actually performed.**

In case that no special regulation exists in the applicable DTA foreign managing directors, board members and authorized signatories can of course also become liable to pay wage tax amounts in Germany for their German working days (economic employer in Germany). As a consequence, the German company can be legally obliged to deduct respective wage tax amounts.

The content of these special DTA regulations, commonly referred to as "managing director clauses", is the that in cross-border situations the right of taxation is allocated to the country where the company resides, e.g. where the place of management is located. However, the location of the actual physical business activity of the managing director, board member or authorized signatories is principally – in contrast to "normal" cases of other employees – irrelevant for the allocation of the right of taxation.

Examples of DTAs with managing directors clause are the DTA with Belgium, the Netherlands, Austria, Poland, Sweden and Switzerland.

Concerning German national domestic law, the German fiscal authorities are of the opinion that regularly an obligation to withhold and remit wage tax is given according to section 38 para 1 of the German Income Tax Act. According to the legal regulation, the same applies for domestic (German) host companies in cases of international secondments of employees if the company bears the economic burden of the relevant wages for the work performed. As of 1 January 2020, the wording of sec. 38 par. 1 s. 2 GITA was amended by the German Annual Tax Act 2019 ("Jahressteuergesetz 2019", BGBl 2019 I p. 2451). Consequently, the German

host company has to be also qualified as domestic employer provided the company would have been obliged to pay the salary according to arm's length principles. The German tax authorities have already consistently maintained this position in the past (cf. BMF letter of 3 May 2018, IV B 2 - S 1300/08/10027).

View of the German tax authorities & valuation issues

According to the German tax authorities, starting point for wage taxation in Germany and corresponding employer obligations (besides actual business activities for and in the interest of the respective domestic company) is regularly the fact that the entry of the aforementioned managing directors of the company in the commercial register is automatically accompanied by statutory legal obligations and (liability) risks that are typically only accepted in exchange for respective remuneration. In this context, the fiscal authorities follow the legal opinion that (at least) part of the overall remuneration owed has to be allocated to Germany.

As a consequence, from German wage tax perspective, the (proportional) salary allocatable to the domestic business activity in Germany must be taxed accordingly via payroll by the German company as domestic- resp. economic employer.

Following the approach of the German tax authorities, it is often questionable in practice how the wage tax assessment bases have to be retroactively determined. Due to the lack of an existing and documented allocation scale of the (foreign) total remuneration and allocation of the portion attributable to the German business activity, there is a risk that the German tax authorities will assess the part relating to Germany with a high rate within the course of a tax estimation (sec. 162 German Fiscal Code).

From our practical experience, the question of a corresponding wage tax withholding obligation for companies in Germany is currently regularly subject wage tax audits. Furthermore, cases are given where that the German fiscal authorities have directly initiated first criminal pre-investigations independently of wage tax audits.

Recommendation for action

Considering the special issues outlined above, the following pro-active approach is recommended in practice as soon as possible:

- **Checking** whether the respective DTA in question contains a special regulation for managing directors, board members and authorized signatories ("managing director clause"), which allocates the taxation right to Germany, irrespective where the actual business activity is performed. Even without a special managing director clause, an examination should be conducted on the basis of the general regulations for the allocation of the taxation right (in particular regarding the domestic working days in Germany).
- **Reduction of wage tax liability- as well as penal (fines) and criminal law risks** by involving professional legal experts concerning employment tax and possibly criminal law (e.g. examination of notification and correction obligations).
- **Reduction of further risks** e.g., in relation to the question of tax credits (avoidance of double taxation).
- **Determination of the correct wage tax assessment base** possibly considering transfer pricing factors if necessary.
- **Adjustment and identification of existing processes** in order to avoid wage tax withholding obligations and wage tax liability risks for the future.

In case you have any further questions regarding the above-mentioned topics, please do not hesitate to contact our experts from PwC's employment tax team. We will be happy to assist you at any time.

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*This document is an excerpt from PwC's People & Organisation (P&O) newsletter for November 2021. You can find the full newsletter with information on important current developments concerning the topics of tax, social security and employment law in human resources under the following link:

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