By PwC Deutschland | 21. April 2025

# Permanent establishment not viewed as employer under relevant double tax treaties

**A foreign permanent establishment of a legally independent person resident in Germany cannot be viewed as employer. This was decided by the Supreme Tax Court in a recent judgment regarding the double tax treaties with the Netherlands, Japan, the UK, Spain, Australia, Ireland, Belgium, Switzerland, Italy, Denmark, Canada, Singapore, Norway, Greece and France.**

## Background

The plaintiff, based in Germany, is a stock corporation and operates worldwide via several branches. The employees working in the foreign branches each had their place of residence in the respective foreign country. They returned to the parent company in Germany at irregular intervals for short-term business trips, e.g. for training or project work.

The employees undertook these domestic business trips in the interests of the respective foreign branch office which also covered the travel expenses in addition to full remuneration for the work performed during this time. The entire costs associated with the activities of these employees were recorded in the accounts of the respective foreign branch. The German parent company did not reimburse these costs in full or in part.

The tax office withheld wage tax from the remuneration of the employees incurred in connection with their domestic business trips.

The appeal before the lower Tax Court of Saxony was dismissed. In the opinion of the court, the case in question involves dependent branches that do not have legal capacity under civil law. Therefore, they could not be a contractual partner and an employer under civil law. The economic employer concept developed by case law is based on a “legally independent person”. According to Art. 5 OECD-Model Treaty, the permanent establishment as such remains a dependent part of its main office and is only deemed to be independent for the purpose of profit allocation according to Art. 7 OECD-Model Treaty.

## Decision

The Supreme Tax Court agreed with the decision of the lower tax court and rejected the appeal as unfounded. The plaintiff's employees who reside in their respective country of employment are subject to limited tax liability in Germany in respect of the wages received for their work in Germany. Germany is entitled to tax the domestic activities of the employees and is not restricted by the so called 183-day rule which generally ensures that those employees who have been working abroad for 183 days or less are taxed in the country of residency. in which they reside.

The Supreme Tax Court went on to say, that - according to national (wage) tax law - the plaintiff, as a domestic employer, is responsible for withholding and declaring wage tax regarding the remuneration attributable to the domestic business trips of foreign resident employees of the branches. In accordance with the relevant double tax treaties (DTT), it was not permitted to abstain from declaring the wage tax for the period in dispute. Germany is entitled to the right of taxation as the country where the activity is carried out, even under the relevant DTT regulations.

According to the established case law of the Supreme Tax Court, an employer defined as such by treaty law, may not only be the employer under civil law, but also another natural or legal person who - from an economic point of view - bears the cost of remuneration for the work performed by the employee. However, a permanent establishment cannot be an employer within the context of treaty law. In such cases, only a person who has the capacity to be resident in one of the two contracting states can be an employer within the treaty framework. A permanent establishment, as an independent part of its head office, cannot be considered as being resident in another state.

The Supreme Tax Court went on to say, that this decision is **not in conflict with the Authorized OECD Approach** (AOA) who deals with the Report on the Attribution of Profits to Permanent Establishments and relies on the separate entity and the arm's length principles. Furthermore, it is **not in conflict with the EU principle of freedom of establishment**. The Supreme Tax Court sees no discrimination of the cross-border situation compared to the purely domestic situation because the parent company would also have to calculate and pay wage tax for employees of a domestic permanent establishment. There is also **no violation of the choice of legal form**. Such a violation cannot be justified by the fact that the parent company is not only faced with increased administrative expenses but has to pay the wage tax. The permanent establishment and the parent company are a single business unit. As the European Court f Justice (ECJ) explained in its judgment of 25 February 2010 in the case C-337/08 X Holding, permanent establishments situated in another Member State and non-resident subsidiaries are not in a comparable situation with regard to the allocation of the power of taxation as provided for in the relevant provisions of the DTT. Therefore, the Member State of origin is not obliged to apply the same tax scheme to non-resident subsidiaries as that which it applies to foreign permanent establishments.

### Source:

Supreme Tax Court decision of 12 December 2024 VI R 25/22, and the largely identical judgments VI R 26/22 and VI R 27/22 – published on 10 April 2025.

**Schlagwörter**

employer, permanent establishment (PE)