By PwC Deutschland | 04 May 2025

Tax exemption of foreign branch income

In two decisions, the Supreme Tax Court has defined in more detail the requirements for a foreign permanent establishment in cross-border situations under a double tax treaty (DTT). If such a treaty exists, double taxation is usually avoided by exempting the foreign branch income from German tax.

Background

In the **case I R 47/21**, a cab operator (plaintiff) living in Germany had access to a Swiss taxicab service center's office in Switzerland due to his membership. That office was equipped with three workstations and was available for three taxi operators. The plaintiff used the office (including a lockable stationary container) for business management duties as well as for personnel administration of his employed cab drivers, preparation of current bookkeeping, accounting, financial control and monitoring compliance with regulatory obligations.

In Switzerland, the plaintiff's income from the taxi business was subject to cantonal income tax and direct federal tax. In addition, the business profits for 2009 and 2010 were also fully taxed in Germany because the tax office assumed that Germany, as the country of residence, had the sole right to tax the profits due to the lack of a permanent establishment in Switzerland. Following a mutual agreement procedure, the plaintiff's income from his business operations was only partly subject to German taxation. The remaining profits were allocated to the foreign permanent establishment. However, the plaintiff did not consent to the result of the mutual agreement.

The tax court of first instance had upheld the claim and treated the plaintiff's entire commercial income from his taxi business in the years of dispute as exempt from German tax and which was only subject to the progression proviso in Germany (i. e. taken into account when establishing the rate to be applied to the rest of the plaintiff’s German income) .

Decisions

The Supreme Tax Court confirmed the decision of the tax court. The court was not bound by the result of the mutual agreement procedure. The treaty requirements for a permanent establishment in Switzerland were met because the plaintiff demonstrated a „rooted business and strong presence“ abroad. This follows from an overall view of both the temporal and local nature of the business establishment and the plaintiff's permanent power of disposal over his business facilities.

The Supreme Tax Court went on to explain that the available personal container was an indication of the permanent power of disposal over the office space. Furthermore, not just auxiliary activities were carried out there.

The main activity of a cab operator with several employed cab drivers is not limited to driving cabs for the purpose of transport. Rather, it also involves the managerial and central entrepreneurial-administrative activities that the cab operator carried out in the office space in Switzerland.

The ability to use the workplace therefore constituted sufficient permanent power of disposal and was "particularly manifested" through the exclusive provision to the plaintiff of a stationary container, which was identified with the plaintiff's business sign and to which only the plaintiff held a key.

Case I R 39/21 dealt with the duration of the presence to qualify as a permanent establishment under tax treaty law. Here, the Supreme Tax Court determined a minimum duration of six months existence abroad and for the business activity to be carried out there. A company that only operates there for less than six months cannot claim an exception from this precondition even if the activity of the company has been carried out entirely in the foreign business establishment.

Source:

Supreme Tax Court decisions of 27 November 2024 re. cases I R 47/21 and I R 39/21 -published on 2 May 2025.

Keywords

Foreign Permanent Establishment (PE), double tax treaty