



PERMANENT ESTABLISHMENT RISK IN GERMANY

Constituting a permanent establishment for tax purposes in Germany often entails considerable tax risks, as these are often not recognized and / or properly registered too late or not at all. Appropriate internal guidelines and raising awareness among the relevant employees are essential in a company that operates beyond the borders of the relevant country.

BASIC PRINCIPLES AND FACTS CONCERNING A PERMANENT ESTABLISHMENT IN GERMANY

In principle, a permanent establishment for tax purposes in Germany is constituted by the existence of a fixed place of business or facility (e.g. branch offices, warehouse, place of management) in Germany, through which the activities of a foreign company are carried out in full or in part in a sustained manner.

SPECIAL CASES:

In addition to the mostly relatively clear and definable basic principles, a permanent establishment for tax purposes in Germany can also be constituted in the following cases without the existence of a fixed place of business:

- **Building sites or constructions or installation projects**
Activities in respect of building sites or constructions or installation projects carried out in Germany can constitute a permanent establishment for tax purposes if they are carried out over a certain period of time. German tax law considers a duration of more than 6 months to be harmful - double taxation agreements concluded by Germany usually provide for 12 months and only sometimes 3 or 6 months.

Practical note: When determining the relevant time, it may happen that the activity times of subcontractors are also included. Interruptions (e.g. due to weather or strikes) or remedial work can also result in the project duration being exceeded unplanned. Furthermore, different projects for the same customer may also be added together if there is a certain connection.

- **Permanent representative**
A so-called representative permanent establishment in Germany with a permanent representative can be established by the fact that a person in Germany conducts the business of a foreign company for the foreign company on a sustained manner and is subject to its instructions.

Practical note: Representative permanent establishments can be constituted in particular by sales employees. If these employees work in Germany, it is therefore essential that they are made aware of this issue.

In connection with permanent establishments from a tax perspective, a detailed examination of the German tax regulations is of particular importance since these may deviate from the local regulations abroad. Important: If possible, this should be done in advance of the intended activities in Germany.

CONSEQUENCES OF CONSTITUTING A PERMANENT ESTABLISHMENT IN GERMANY

A German permanent establishment for tax purposes is not an independent legal entity such as a German subsidiary but forms a legal entity with its foreign head office. For tax purposes, however, a permanent establishment is assumed to be independent and therefore constitutes a limited tax liability in Germany. The corresponding profits of the permanent establishment are subject to tax in Germany.

Depending on the double taxation agreement and the respective local tax regulations, the permanent establishment profits taxed in Germany may be exempt from taxation abroad or the German tax will be offset against the local tax abroad.

Practical note: The allocation of profits between the foreign head office and the German permanent establishment is often not very easy and is particularly problematic in the special cases outlined above (permanent representative and building sites or constructions or installation projects constituting a permanent establishment).

In addition to the limited tax liability, also the following tax obligations apply if a permanent establishment in Germany is constituted:

- Trade tax liability
- Obligation to notify the municipality / the tax office
- Duty to keep accounts
- Transfer Pricing documentation requirements
- Payroll and potential sales tax obligations

RISK MITIGATION IN RELATION TO PERMANENT ESTABLISHMENTS FROM A TAX PERSPECTIVE IN GERMANY

To successfully mitigate any risk in relation to permanent establishments from a tax perspective in Germany, we recommend:

- A detailed examination of the individual case, if possible before implementation
- The corresponding development, implementation and enforcement of internal guidelines and the training of sales staff and employees in the human resources department
- The thorough analysis between establishing a local legal entity in Germany and a permanent establishment for tax purpose

