

BFH rules on conditions of German PE due to service provider activities

Activities of a domestic service provider generally do not cause a foreign real estate investor to have a German PE.

In a decision dated 23 March 2022 and published on 11 August 2022, Germany's federal tax court (BFH) ruled that the activities of a German third party property management company engaged by a Luxembourg tax resident entity to manage its German real estate investments generally should not create a German permanent establishment (PE) for the Luxembourg tax resident entity. The BFH referred the case back to the lower tax court to determine whether a German PE existed based on the facts of the case and the principles set forth by the BFH in its decision.

Foreign investments in German real estate are typically made via foreign entities that own the German real estate and manage the real estate from abroad. Rental income with regard to such real estate generally is subject to German corporate income tax at the level of the foreign entity without the requirement of a German PE (i.e., a fixed place of business such as a business premises, office, or other facility). For trade tax purposes, however, a German PE is required for trade tax to be levied on the rental income of such real estate. The local trade tax can be a significant tax cost for businesses, with applicable trade tax rates varying from 7-17% depending on where the PE is located.

Generally, a foreign real estate investor managing German real estate from outside of Germany does not create a German PE; however, it has not been clear to what extent outsourcing such management activities to a domestic third party service provider may deem the foreign investor as having a German PE at the service provider's premises.

In the case decided by the BFH, a Luxembourg tax resident entity ("Luxembourg investor") engaged a German third party property management company to manage its German real estate investments. The management company also managed German real estate investments owned by other group entities of the Luxembourg investor. The employees of the Luxembourg investor and the management company were not identical. Also, the management bodies of the Luxembourg investor and the management company consisted of different individuals.

In the absence of a German PE, the Luxembourg investor did not file a German trade tax return (but did file a German corporate income tax return). Arguing that the activities of the management company would cause the Luxembourg investor to have a PE in Germany and, hence, a taxable nexus for both German corporate income tax and trade tax purposes, the German tax authorities assessed trade tax on the Luxembourg investor. The Luxembourg investor appealed the trade tax assessment. After the lower tax court sided with the tax authorities and confirmed the existence of a German PE, the case was brought before the BFH.

In its decision, the BFH ruled that the activities of a domestic third party service provider generally do not create a German PE for a foreign real estate investor. The court further ruled that only in exceptional cases where a foreign investor is carrying out its own (asset management) activities at the premises or facilities of the service provider or in cases where such (asset management) activities are deemed to exist because the management bodies of the foreign investor and the service provider are identical, a PE may be created for the foreign investor. In other words, only if the foreign investor itself actually and continuously supervises the service provider's activities at its premises or does so by having the same persons acting as the management body of both the foreign investor and the service provider, a German PE at the premises of the service provider may be created. The BFH also pointed out that for triggering a German PE, a certain degree of permanency is required. As

the lower tax court did not fully analyze the fact pattern in this regard for a potential PE (i.e., whether the Luxembourg investor was effectively managed out of the management company's premises), the BFH referred the case back to the lower tax court, requesting that the lower tax court decide on the case taking into account the principles as established by the BFH.

The ruling provides welcome clarity on the question as to when a domestic third party service provider may cause a foreign real estate investor to have a German PE. It clarifies that the mere supervision of the service provider from abroad is not sufficient to create a PE in Germany for a foreign investor. Foreign real estate investors should analyze the guidelines as described by the BFH to make sure that the threshold of a German PE is not reached and the rental income from the real estate is not subject to trade tax.

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