

Does employee's locker for keeping private belongings abroad create permanent establishment for employer? 3/40/24



Consultant, Tax, PwC Latvia
Aleksandrs Afanasjevs



Director, Tax, and Head of Pan-Baltic
People and Organisation Practice, PwC
Latvia
Irena Arbidane

Today's business often spreads across several countries, making it difficult to tax business income properly. A key challenge for companies is to determine whether they have a permanent establishment (PE) abroad. The situation is complicated further by countries possibly applying different PE criteria and interpreting PE rules in their double tax treaties differently.

Finding a PE remains a controversial issue that often requires the involvement of a national court to hear corporate disputes with tax authorities. In this article we will look at two German court cases examining how a PE arises from a non-resident company using a fixed place of business in Germany. The situations outlined below indicate how the courts might analyse evidence of the non-resident having a fixed place of business for PE purposes.

Although German case law cannot be used to measure PE risk in Latvia, these court findings provide an overview of the methods of analysis used by the national court and can help Latvian companies predict PE risk when undertaking similar activities in Germany.

Case 1: Services acquired from a foreign company

A German company residing in Luxembourg for tax purposes ('L') owns some real estate in Germany. L acquires property management services from another German company resident in Germany for tax purposes ('G'). The services include entering into and terminating rental, insurance, service and employment contracts, as well as representing L's interests in communicating with companies, banks and government agencies. L has issued a power of attorney to G to manage the property.

Having assessed these circumstances, the Federal Fiscal Court (*Bundesfinanzhof*) decided that L's activities do not amount to a PE because it does not have a fixed place of business on G's premises. If we are to claim that L uses G's place of business for its operations, we would need to demonstrate that L regularly supervises G's services. This means there must be evidence that L's employees give particular instructions on, for instance, the manner and terms for entering into contracts and on ways to communicate with businesses and government agencies, which significantly affects how G provides its services.

In this case, neither issuing the power of attorney nor delegating some of the business will amount to a PE unless supervision is found.

Case 2: Using a locker to provide services abroad

An engineer is the sole owner of a UK company providing aviation maintenance services to another UK company. The engineer provides these services by working at a German airport where he has access to staff facilities, including an individual locker and a safe for keeping his private belongings and work clothes.

The court agreed with the German tax authority's view that the company has a fixed place of business and a PE in Germany. The ruling was based on the engineer having access to the airport staff facilities, where he kept his private belongings during the working hours and his work clothes after the working hours, which strengthens his link to the airport as a place of business. The court said it was theoretically possible for the engineer to keep his work tools in the locker, which points to a close link to the place. The court also held that under these circumstances it was irrelevant that the facilities were used by other employees and the engineer's right to use them could be revoked.

It follows that a PE can arise in Germany not only from the provision of services but also from the practical use of certain assets and infrastructure. Even if the person shares the place with others and does not use it permanently, the main criteria are the nature of the activity and the link to the place, as well as the goal to use it permanently for providing services. The court held that using assets where such services are rendered strengthens the employee's link to the place, creating a PE. This confirms the recent practice that finding a PE depends on practical circumstances, not only the formal right to use a place.

Takeaways

Having analysed the two cases, we note that the German judicial methodology for finding a PE indicates a tendency to analyse in detail not only the formal criteria but also the company's actual operations and the geographical link to the place. We can see that the court not only pays attention to generally recognised hallmarks but also scrupulously investigates some less obvious evidence, such as the use of assets and facilities. This means that Latvian companies doing business in Germany should also consider these aspects to avoid PE risk.