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Creation of a permanent establishment by outsourcing management responsibilities to a domestic management company

August 13, 2020

The Fiscal Court of Berlin-Brandenburg has ruled in its decision from November 21st, 2019, that a corporation having its place of business management located outside of Germany can create a permanent establishment in Germany, solely by providing a German tax resident property management company with extensive management responsibilities. Even if this ruling discusses the rare case of a corporation which has its registered seat domestically but its place of management abroad at the domicile of its managing director, the consequences of this ruling can be applied to cases, where entirely non-domestic companies hand over management responsibilities to German tax resident management companies.

This ruling is especially relevant for common inbound real estate structures using non-domestic companies to hold interest in domestic real estate.

The Facts

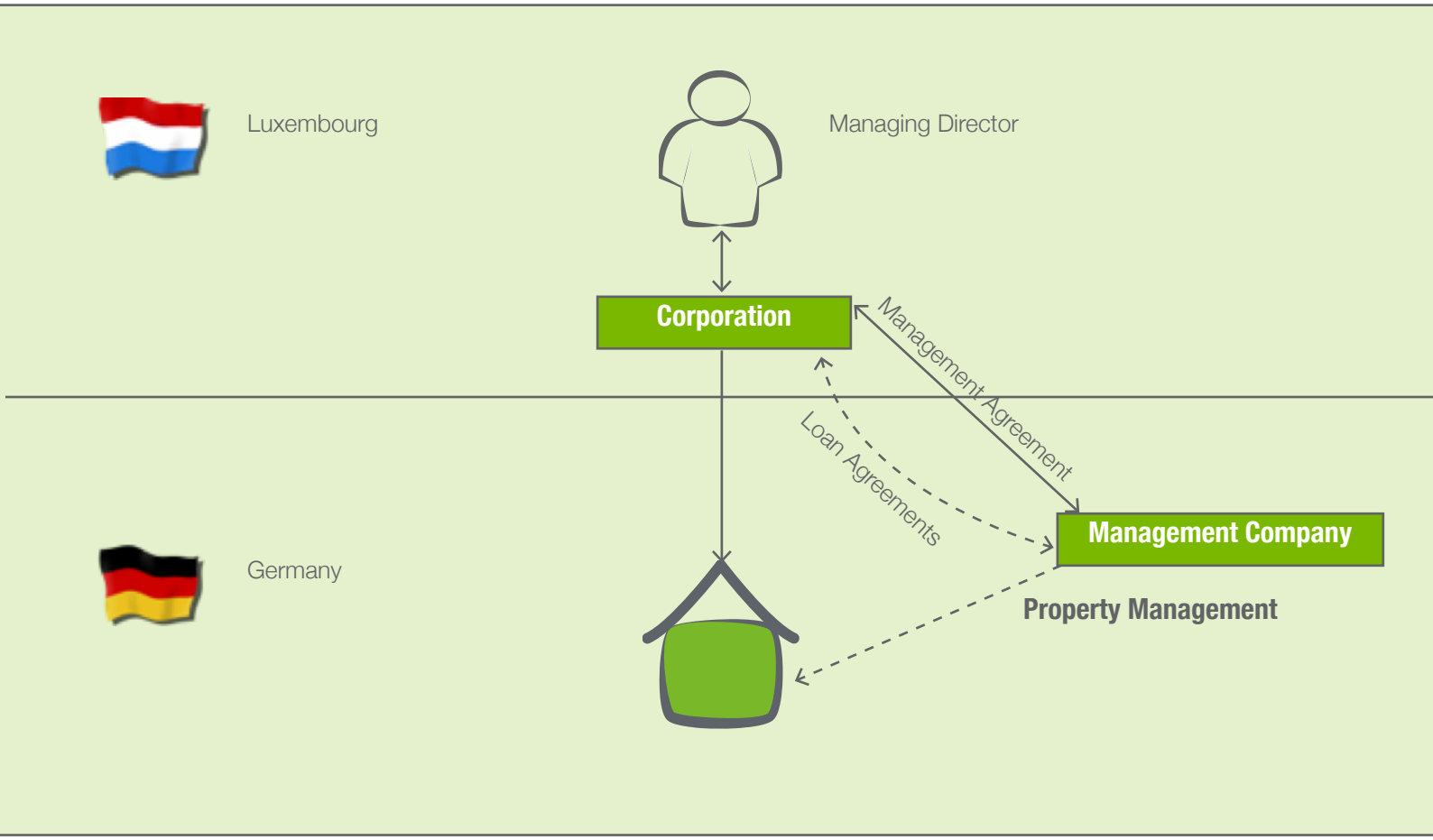
For better understanding, we modify the facts of the case in such regard that we assume that the plaintiff owning a real estate property in Germany is a corporate entity that had its tax residence (registered seat and place of management) in Luxembourg. Being based entirely abroad, the company did not operate any office within Germany. The real estate management was conducted by a German tax resident management company, which was mandated with extensive managing responsibilities and which used their own office for said tasks. The mandate included several responsibilities, such as the right to enter into or cancel tenancy agreements. In 2013, the real estate property was sold by the Luxemburg corporation. The tax authorities determined the sale proceeds accordingly and assessed the trade tax rate with the corresponding payable trade tax. The plaintiff contested the tax assessment notice, claiming that he was not operating a permanent establishment and hence no business enterprise, which could be subject to trade tax.

Legal background and relevancy of the ruling

Every business enterprise which is located and operated in Germany is subject to trade tax. Such business enterprise is deemed to operate domestically, if it has a permanent establishment in Germany. All corporate entities (even non-domestic ones) are deemed to be business enterprises. Resulting from this principle, the question regarding a corporate entities' liability to trade tax solely depends on the question whether the corporation has a permanent establishment in Germany. Thus, the present ruling is also highly relevant for corporate entities being located entirely outside of Germany.

The court's decision

The court ruled that the plaintiff indeed had a permanent establishment located in Germany during the case year of 2013, which led to the plaintiff being subject to trade tax in that period. The court referred to Section 12 Paragraph Number 1-3 of the German Fiscal Code, according to which especially "places of management, branches and offices" are regarded as permanent establishments. It is crucial in this regard that the office of the management company in Germany was regarded as being used for the plaintiff's business operations (see also Federal Fiscal Court (BFH) February 23th, 2011 – I R 52/10).



Can the office of a management company qualify as a permanent establishment?

According to the court, the permanent establishment is constituted by the office of the management company. As to the question of whether an office of a management company can qualify as a permanent establishment of the outsourcing company, the Federal Fiscal Court has already taken position in this regard in a ruling dating back to 2011 (BFH August 24th, 2011 – I R 46/10). In this judgement the Federal Fiscal Court ruled that the premises of a management company can indeed constitute a permanent establishment of an outsourcing company even though the outsourcing company has no effective authority on the premises of the management company. Key to this decision was the fact that the outsourcing company in this case was able to closely monitor the operations of the management company. This argument was supported by the fact that the management company and the outsourcing company were managed by identical directors.

Such principle originating from the quoted ruling and two other rulings by the Federal Fiscal Court (BFH June 8th, 2015 – I B 3/14; BFH February 23rd 2011 – I R 52/10) was applied to the present case. According to the court, the management company was tasked with management responsibilities of the plaintiff in the same way and even undertook relevant communication matters with the competent authorities. The fact that the plaintiff and the management company operated several reciprocal loan agreements underlined their “deeply-rooted business relationship”. It has to be noted however, that in the present ruling, the plaintiff and the management company were not managed by the same group of directors.

Evaluation of the ruling – New milestone or overreaching?

Requirements under which the office of a German tax resident management company may qualify as a permanent establishment of a non-resident outsourcing entity are not quite clear yet. Revision procedure at the Federal Fiscal Court, which will hopefully bring more clarity, is already in process (Reference I R 10/20).

Documents to beinformed:

- Ruling of the Fiscal Court Berlin-Brandenburg dated November 21st, 2019
- Ruling of the Federal Fiscal Court (Bundesfinanzhof) dated August 24th, 2011

After a closer glance at the facts, we have some doubts that the Federal Fiscal Court will affirm the court's ruling without any objection:

In comparison to the court's quoted ruling dating back to 2011, the mandate assigned to the management company was not as extensive. The management company in the present case had no authority to conducted purchases and sales of the plaintiff's assets (in this case the real estate property).

Another key difference to all the three quoted rulings is the fact that the managing directors of the plaintiff and the managing directors of the managing company were not the same persons. In our opinion, the personal identity of the managing directors is essential in order to assume that the managing directors actually work in their position as directors of the outsourcing company and not in their position as directors of the management company in the premises of the management company. It is surprising that the court did not even mention this discrepancy.

In the further course of the ruling, the court assumed a "deeply-rooted business relationship" between the plaintiff and the management company. If, according to the court, an extensive management agreement is sufficient to constitute a permanent establishment at the office of the management company, it is unclear in which way such a relationship is even relevant to the case. If we assume that such relationship is indeed necessary, the court draws the line very narrowly. Its assumption of a "deeply-rooted business relationship" was based on loan agreements between the plaintiff and the management company which amounted to 1,200 and 6,000 Euros. Considering that the real estate property was valued at 1.5 Millions Euro, we believe that these amounts are rather much neglectable.

The risk of a permanent establishment in Germany – What can be done?

Even if the aspect of personal identity of the management was completely neglected by the Fiscal Court, we still believe that this aspect is crucial for the creation of a permanent establishment in a management company. After all, the relevant rulings of the Federal Fiscal Court regarding the premises of German tax resident management companies constituting permanent establishments are all based on the fact that the management of both the property-owning and the management company was being conducted by exactly the same persons.

It is still highly advisable to not equip single management companies with broad management responsibilities. Essential business decisions, such as the purchase or sale of assets, should remain with the management of the property-owning company.

The outsourcing of management responsibilities to management companies still remains a balancing act and will remain this way for quite some time. Please do not hesitate to contact us if you require advise in this regard!

be in touch: Any questions? Please do not hesitate to contact us!

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