Tax treatment of employees of French permanent establishments and representatives of foreign firms on secondment in Germany

💡 Reminder:

As a general rule, salary is taxable in the country where the work is carried out. Most international tax treaties provide for an exception for assignments undertaken by employees on behalf of their employer, provided that all three of the following conditions are met:

- (1) The employee does not spend more than 183 days in the foreign country during the *tax* year,
- (2) And the remuneration is paid by an employer or on behalf of an employer who is not a resident of the foreign country,
- (3) And the salary is not borne by a permanent establishment or a fixed base of the employer in the foreign country.

The vast majority of employees reside in the same country as their employer, but this must be verified on the basis of various criteria (place of work, permanent residence, centre of vital and economic interests, habitual residence, nationality, etc.).

Point to note: an employee of a Foreign Firm Representative who undertakes business travel within their employer's country of residence must have tax deducted at source for the days spent in that country, as condition 2 is not met.

📃 Please note: **Since 1 January 2025, the German approach to the taxation of wages has created a risk of double taxation, particularly for French resident employees of French permanent establishments and representatives of foreign firms headquartered in Germany.**

According to the German tax authorities and the Bundesfinanzhof (Germany's highest tax court) (Case VI R 25/22 of 12 December 2024), employees of foreign permanent establishments (including, in particular, French ones) whose head office is located in Germany, and who work in Germany, carry out their work in their employer's country of residence. For the purposes of income tax, a permanent establishment is therefore not an 'employer'. The relevant salary is therefore taxable in Germany from the first day of employment in that country. The OECD's Authorised Approach (AOA), according to which permanent establishments must be regarded as separate and independent enterprises, does not therefore apply in relation to income tax.

📄 **An uncertain position for France:** the implications regarding income tax for German permanent establishments of French companies, and vice versa, remain unclear and carry a risk of double taxation. From the French perspective, the application of Article 13(4) of the Franco-German tax treaty (aligned with Article 15(2) of the OECD Model Tax Convention) depends largely on the interpretation of the term 'employer' within the meaning of subparagraph (b).

French tax practice tends to favour an analysis based on economic substance rather than purely formal criteria. The employer can therefore be identified by referring to the entity which 1) exercises effective authority and control over the employee's work, 2) bears the associated risks and responsibilities, and 3) derives an economic benefit from the services provided. This approach does not automatically preclude a more formal interpretation, particularly where the economic indicators are not clearly aligned.

The French tax authorities often prioritise substance over form. A decision of the Paris Administrative Court of Appeal dated 10 June 2022 (No. 21PA01586) shows that French courts may rely on the economic and functional reality of the employment relationship to determine the employer for the purposes of the agreement. Nevertheless, this case law does not preclude other interpretations in different factual circumstances.

Overall, under current French law, the identification of the employer within the meaning of Article 15(2) of the OECD Convention remains open to interpretation and may reasonably be assessed in several ways, depending on the specific facts and the weight given to economic criteria as opposed to formal criteria.

💡 Sanctions

The employer is required to deduct and pay income tax on behalf of the employee. In accordance with Section 42d of the EStG (German Income Tax Act), the employer is liable for any unpaid income tax. The tax authorities may claim the tax directly from the employer if the employer has failed to fulfil their obligation to deduct tax at source from wages, and may impose penalties:

- Late payment penalties under Section 240 of the German Fiscal Code (AO): 1% per month on the amount of unpaid tax
- Late payment penalties under Section 152 of the German Fiscal Code (AO) may apply in the event of late submission of the payroll tax return.

Criminal liability in tax matters:

- In the event of deliberate non-payment -> tax fraud (Section 370 AO): a fine or a prison sentence of up to 5 years in less serious cases, or up to 10 years in more serious cases.
- In cases of negligence -> unintentional tax evasion (Section 378 AO): a fine of up to €50,000.

➔ Next steps for employers

Given the uncertainty surrounding cross-border situations between France and Germany, employers need to reassess their employees' short-term travel arrangements, their payroll structures and their documentation processes.
We are, of course, at your disposal to help you navigate this issue, analyse your current structures, identify areas of potential risk and implement compliant withholding tax procedures.

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